Policy Issues for the Future

1988 NIRA/IRPP Symposium

Edited by
K. Lorne Brownsey

89-03956/

The Institute for Research on Public Policy
L'Institut de recherches politiques

A national, independent, research organization
Un organisme de recherche national et indépendant

Founded in 1972, The Institute for Research on Public Policy is a national organization whose independence and autonomy are ensured by the revenues of an endowment fund which is supported by the federal and provincial governments and by the private sector. In addition, the Institute receives grants and contracts from governments, corporations and foundations to carry out specific research projects.

The *raison d'être* of the Institute is threefold:

- To act as a catalyst within the national community by helping to facilitate informed public debate on issues of major public interest
- To stimulate participation by all segments of the national community in the process that leads to public policy making
- To find practical solutions to important public policy problems, thus aiding in the development of sound public policies.

The Institute is governed by a Board of Directors, which is the decision-making body, and a Council of Trustees, which advises the Board on matters related to the research direction of the Institute. Day-to-day administration of the Institute's policies, programs and staff is the responsibility of the president.

The Institute operates in a decentralized way, employing researchers located across Canada. This ensures that research undertaken will include contributions from all regions of the country.

Wherever possible, the Institute will try to promote public understanding of, and discussion on, issues of national importance, with clarity and impartiality. Conclusions or recommendations in the Institute's publications are solely those of the author and should not be attributed to the Board of Directors, Council of Trustees, or contributors to the Institute.

The president bears final responsibility for the decision to publish a manuscript under the Institute's imprint. In reaching this decision, he is advised on the accuracy and objectivity of a manuscript by both Institute staff and outside reviewers. Publication of a manuscript signifies that it is deemed to be a competent treatment of a subject worthy of public consideration.

Canada-Japan:
Policy Issues for the Future

Canada-Japan:
Policy Issues for the Future

edited by

K. Lorne Brownsey

Published by

The Institute for Research on Public Policy
L'Institut de recherches politiques

With financial support from

Asia Pacific Foundation of Canada
Fondation Asie Pacifique du Canada

Copyright © The Institute for Research on Public Policy 1989
All rights reserved

Printed in Canada

Legal Deposit First Quarter
Bibliothèque nationale du Québec

Canadian Cataloguing in Publication Data

Main entry under title:

Canada-Japan : policy issues for the future

Prefatory material in English and French.
"Papers . . . developed for an informal symposium held in Vancouver in April 1988".—Foreword.
ISBN 0-88645-086-1

1. Canada—Economic conditions—1971- *
2. Japan—Economic conditions—1945-
3. Canada—Social policy. 4. Japan—Social policy. 5. Canada—Foreign economic relations—Japan. 6. Japan—Foreign economic relations—Canada. I. Brownsey, K. Lorne, 1952- II. Institute for Research on Public Policy.

HC115.C36 1989 330.971'064 C89-098551-0

The camera-ready copy for this publication was created on a Xerox 6085 Desktop Publishing System.

The Institute for Research on Public Policy
L'Institut de recherches politiques
P.O. Box 3670 South
Halifax, Nova Scotia B3J 3K6

Contents

Foreword vii

Avant-propos xi

Introduction 1
H.E. English and K. Lorne Brownsey

Japan's Tasks in the 1990s 13
Junnosuke Kishida

Comments 24

Structural Change in the Japanese Economy 29
Yutaka Kosai

Comments 39

Social Policy in Changing Japan 47
Noriyuki Takayama

Comments 53

Warning on Techno-Nationalism: From Economic Friction to Technological Friction 57
Toru Yano

Comments 68

Japan–Canada Relations in Perspective 73
Mikiko Iwasaki

Comments 79

Canada's Economic Prospects Over the Medium Term 85
T.A. Wilson

Comments 121

Canada–Japan Economic Relations: Bilateral, Trilateral and Multilateral Dimensions 125
Murray G. Smith

Comments 138

Demographic Aging in Canada: Implications for Public Policy 145
Shirley B. Seward

Comments 168

Global Economy/Domestic Society: Competing Challenges to Governance in Canada 173
Richard Simeon

Comments 189

Sustainable Economic Development 195
Jim MacNeill

Comments 209

Members of the Institute 215

Institute Management 219

Related Publications 221

Foreword

Heads nod when visiting dignitaries proclaim that "the 21st century is the Asian century" or announce the dawn of "the Age of the Pacific". Within Canada, there is ample rhetoric emphasizing the growth of trade across the Pacific, and the importance of the Asia-Pacific region for us more generally.

There is some acknowledgment of the region's meteoric economic growth, and its present role as the most dynamic element of a world economy in which issues and organizations—both public and private—increasingly transcend national boundaries. There is occasional recognition of Japan's moves to assume international responsibilities going far beyond its present status as a major economic and financial force in the world, of the inexorable emergence of China as a major player in the world economy, of striking Pacific initiatives on the part of the Soviet Union, even of the potential impact of an awakening Indian sub-continent.

But there often seems very little real conviction under all this rhetoric about Canada's interest in the region: academic awareness and acknowledgment of the dramatic changes carried in upon Canada by the prevailing winds across the Western boundaries seem distressingly rarely matched by action to learn more about their possible sources and likely consequences. If Canadians are serious about becoming full and significant members of this emerging Pacific community—and they had better be—then much more substantial commitments to participation in Pacific markets for goods, services, technology and ideas, as well as capital and conversation, will be essential.

Pacific nations are seeing the transition of their agricultural or industrial structures into service economies, and the transformation of their social structures into

information societies, in very different ways, from very different starting points. They are becoming aware of the pressures of global interdependence not just in trading systems, development assistance and security, but in climate change, renewable resource depletion and environmental externalities, and again they are responding differently.

In no country is the extent of social and economic transformation greater or more dramatic than Japan. In no country are revolutionary changes in expectations, attitudes, and structures likely to have greater impact on the world to which those of us in North America must adapt than Japan. No country outside of North America matters more to us. Yet we in Canada know little of Asia in general or Japan in particular; startlingly little real effort at understanding follows the initial rhetorical flourishes.

Canadians can ill afford to be ill-informed about Asia and the Pacific Basin, even if most of our ancestors did cross the Atlantic rather than the Pacific, and most of our present links, commercial and otherwise, are to the south rather than the west. We must enhance our understanding not only of what is happening in the Pacific, but even more important, how our neighbours across the Pacific view what is happening in their world. We need a greater mutual appreciation of the common social, economic, political, and environmental challenges we all face, as well as of the particular manifestations of social change that separate communities encounter individually. Canada's effectiveness in international affairs and as an aspiring member of a Pacific community will depend considerably on its ability to base its actions and its policies on an understanding of the peoples, aspirations, attitudes, intentions, and relationships of nations in the Pacific.

It is for this reason that this Institute has made the development of an Asia-Pacific research agenda a priority task, and has encouraged multilateral and bilateral links with researchers and research institutes in the region. These include a workshop series (sponsored by the Management for Change Program of the Canadian International Development Agency) that brings together analysts from more than a dozen Asia-Pacific nations to examine issues of governance and public management; analytical and organizational work, through the Pacific Economic Cooperation Conference (PECC), on institutional development in the Pacific and assessments of environmental quality and sustainable development as well as resource use and trade; a collaborative research project with China's International Trade Research Institute (ITRI) on that country's foreign trade sector; and proposals for work with the Thailand Development Research Institute on a number of joint research undertakings.

In recognition of the particular importance of Japan in terms of its bilateral trade with Canada, its increasing presence as a major power in international society, and the potential for the development of Canada/Japan relations to offset some of the dominant influence of the U.S. on both countries, IRPP attaches particular significance to a collaborative research link with Japan's prestigious National Institute for Research Advancement (NIRA).

The papers in this volume were developed for an informal symposium held in Vancouver in April 1988, co-sponsored by IRPP and NIRA. They provide an overview of some of the key policy issues likely to be faced by both countries in the coming decade. Their scope is wide and at times quite speculative: they range from descriptions of

possible realigned world political orders to questions of international trade and domestic economic priorities; from the "greying" of the populations of the industrial world and associated social policy issues such as health care and pensions to the imperative of implementing sustainable economic development worldwide; and they centre on the many vexing challenges of governability that all nation states are now confronting. From this wide-ranging initial survey, a number of more specific topics were identified for a proposed series of collaborative research meetings between the two Institutes. In this light, I am happy to note that a second IRPP/NIRA symposium will take place in Tokyo in April 1989 to examine issues of globalization and international market unification and Canadian and Japanese responses to them.

Learning to know and understand one another is slow business even for two interested people. For two vastly different communities long isolated from one another, the process can only be long, stumbling and incomplete. With luck, this modest collaborative research initiative and the dissemination of its findings more widely to policy-makers, academics, businessmen and other interested communities in the two countries will contribute a little to some strengthening of the relationship between Japan and Canada, which, although friendly, cannot yet be described as grounded in any widespread knowledge of our respective societies. In turn, this strengthened relationship should contribute to greater and more harmonious trade and economic relationships, and greater cooperation on trans-national issues.

The Institute is pleased to acknowledge the generous financial support for the Vancouver symposium and this publication from the Government of British Columbia (Ministry of International Business and Immigration), the Asia Pacific Foundation, the City of Vancouver and Westar Mining.

Rod Dobell
President

Avant-propos

Lorsque des dignitaires étrangers qui nous rendent visite déclarent que "le 21ème siècle sera le siècle de l'Asie" ou annoncent l'aube de "l'âge du Pacifique", on réagit par un signe de tête approbateur. Au Canada même, on se livre à de multiples considérations sur l'augmentation des échanges entre une rive du Pacifique et l'autre, et plus généralement sur l'importance de la Région de l'Asie du Pacifique pour notre pays.

On commence à enregistrer la montée rapide de l'économie de cette région et le fait qu'elle est devenue l'un des principaux facteurs dynamiques dans une économie mondiale où les questions en jeu et les organismes en place, que ceux-ci soient publics ou privés, transcendent de plus en plus les frontières nationales. On reconnaît à l'occasion que le Japon est en train d'assumer des responsabilités internationales qui vont au-delà de ses obligations en tant qu'une des puissances économiques et financières les plus importantes au monde. On fait également des observations sur l'entrée inévitable de la Chine dans l'économie mondiale et le rôle majeur qu'elle aura à y jouer, sur les initiatives impressionnantes prises par l'Union soviétique dans le Pacifique et même sur les effets que pourrait avoir l'éveil du sous-continent indien.

Toutefois, derrière toute cette rhétorique, il semble y avoir très peu de véritables convictions quant aux intérêts dans cette région, la plupart du temps. La prise de conscience et la reconnaissance académiques de ces changements spectaculaires, dues aux vents d'est prédominants qui soufflent sur notre frontière occidentale, semblent malheureusement très rarement suivies de mesures qui permettraient d'en apprendre davantage sur les causes de ces changements et sur leurs effets éventuels. Si les Canadiens envisagent sérieusement de devenir membres à part entière de la communauté des pays du Pacifique en cours de formation, et ils ont tout intérêt à le

devenir, il leur faudra alors s'engager beaucoup plus concrètement dans les marchés du Pacifique, sur le plan des biens, des services, de la technologie et des idées, aussi bien qu'en matière de capitaux et d'ententes.

Les pays du Pacifique voient leurs économies passer du stade agricole et industriel à celui des services, et leurs sociétés se transformer en sociétés d'information, cela de diverses manières et à partir de situations de base différentes. Ils deviennent conscients des pressions exercées du fait de l'interdépendance entre pays, non seulement au niveau des systèmes des échanges commerciaux, de l'aide au développement et de la sécurité, mais aussi à celui des changements climatiques, de l'épuisement des ressources renouvelables et des problèmes de l'environnement et, là encore, ils apportent des solutions variées à ces questions.

L'ampleur des transformations sociales et économiques n'est nulle part aussi grande qu'au Japon. En nul autre pays qu'au Japon les changements radicaux dans les projets, les attitudes et les structures ne sont probablement appelés à avoir autant d'impact sur la physionomie d'un monde auquel nous autres, en Amérique du Nord, devrons nous adapter. Aucun pays en dehors de l'Amérique du Nord n'a autant d'importance pour nous. Pourtant, nous les Canadiens, nous connaissons très peu de choses sur l'Asie en général et sur le Japon en particulier; il est étonnant de constater que l'ample flot de notre rhétorique n'est suivi que de très peu d'efforts sérieux pour comprendre la situation.

Les Canadiens ne peuvent guère se permettre de rester mal renseignés sur l'Asie et le bassin du Pacifique, même si la plupart de nos ancêtres sont originaires d'outre-Atlantique et non pas d'outre-Pacifique; même si nos relations actuelles, commerciales et autres, se font avec le Sud plutôt qu'avec l'Ouest. Nous devons renforcer notre compréhension, non seulement de ce qui se passe dans le Pacifique, mais aussi de la manière dont nos vis-à-vis voient le monde, de l'autre côté de cet océan. Nous avons besoin d'en venir à une meilleure appréciation mutuelle des défis sociaux, économiques, politiques et environnementaux auxquels nous devons tous faire face, ainsi qu'à une meilleure connaissance des problèmes particuliers apportés par les changements sociaux survenant dans les différentes communautés. L'efficacité du Canada sur la scène internationale et le rôle qu'il voudrait jouer au sein de la communauté du Pacifique dépendent en grande partie de la capacité qu'aura notre pays à fonder ses actions et ses politiques sur la compréhension des peuples, sur les aspirations, les attitudes et les intentions des pays du Pacifique et sur les liens qui les unissent.

C'est pour cette raison que l'Institut a mis la priorité sur la recherche en matière de développement dans l'Asie du Pacifique et a encouragé les rapports multilatéraux et bilatéraux avec les chercheurs et les instituts de recherche de cette région. Ceci inclut: une série d'ateliers (parrainée par le programme de gestion pour le changement de l'Agence canadienne de développement international) destinés à permettre la rencontre d'analystes de plus d'une douzaine de pays de l'Asie du Pacifique, afin d'examiner ensemble les questions relatives à la capacité de gouverner et à la gestion du secteur public; un travail d'analyse et d'organisation, dans le cadre du Congrès sur la coopération économique dans le Pacifique (PECC), portant sur le développement des structures institutionnelles dans le Pacifique et sur l'évaluation de la qualité de l'environnement et

du développement durable, aussi bien que sur l'utilisation et le commerce des ressources naturelles; un projet de recherche commun, en collaboration avec l'Institut de recherches en commerce international de la Chine (ITRI), axé sur le commerce international de ce pays; des propositions de travail avec l'Institut thaïlandais de recherches en matière de développement, portant sur un certain nombre de projets de recherche en commun.

Étant donné l'importance particulière du Japon en matière de commerce avec le Canada, son rôle croissant sur la scène internationale et le potentiel que représentent les relations entre le Canada et le Japon pour contrebalancer en partie l'influence dominante qu'exercent les États-Unis sur ces deux pays, l'IRP attache une importance particulière à l'existence d'une collaboration de recherche avec le prestigieux Institut national japonais pour l'avancement de la recherche (NIRA).

Les études présentées dans ce volume ont été mises au point pour un symposium qui s'est tenu à Vancouver en avril 1988, sous l'égide de l'IRP et du NIRA. Elles offrent une vue d'ensemble de certains des problèmes fondamentaux auxquels les deux pays auront vraisemblablement à faire face au cours de la prochaine décennie. Elles portent sur un vaste domaine, de nature hypothétique parfois. Elles vont des descriptions d'une possible réorganisation des structures politiques mondiales aux questions de priorité en matière de commerce international et d'économie domestique; du vieillissement des populations du monde industrialisé et des problèmes qui sont associés à ce phénomène, comme les soins de santé et la retraite, aux impératifs qui s'imposent mondialement pour l'établissement d'un développement économique durable; et elles sont particulièrement axées sur les multiples défis assez frustrants auxquels tous les pays doivent maintenant faire face en matière de gouvernement. À partir de cette large vue d'ensemble, on a retenu un certain nombre de sujets de recherche plus spécifiques qu'on se propose d'examiner au cours d'une série de rencontres entre les deux instituts. À cet effet, je suis heureux de faire remarquer qu'un second symposium entre l'IRP et le NIRA aura lieu à Tokyo en avril 1989, afin d'étudier les problèmes de globalisation et d'unification du marché international ainsi que les réactions du Canada et du Japon face à cette conjoncture.

Apprendre à se bien connaître mutuellement est une oeuvre de longue haleine, même pour deux pays qui s'intéressent l'un à l'autre. Lorsque deux communautés très différentes ont été isolées l'une de l'autre pendant bien longtemps, le processus de rapprochement ne peut qu'être long, hésitant et partiel. Avec un peu de chance, cette modeste initiative de recherche en commun et la large diffusion de ses résultats dans les deux pays auprès des responsables politiques, des universitaires, des gens d'affaires et des autres groupes intéressés, devraient contribuer, dans une certaine mesure, au renforcement des relations entre le Japon et le Canada. Ces relations, bien qu'amicales, ne peuvent pas encore être décrites comme émanant d'une connaissance largement partagée de nos communautés respectives. Le renforcement de nos contacts devrait à son tour favoriser l'établissement de relations plus nombreuses et plus harmonieuses en matière de commerce et d'économie et une plus grande coopération sur les questions transnationales.

L'Institut est heureux d'avoir l'occasion de remercier ici le gouvernement de la Colombie-Britannique (le ministère du Commerce international et de l'Immigration), la

Fondation de l'Asie du Pacifique, la Ville de Vancouver et Westar Mining, de leur généreux appui financier pour la tenue du symposium de Vancouver et la préparation de la présente publication.

Rod Dobell
Président

Introduction

H.E. English
K. Lorne Brownsey

The April 1988 NIRA/IRPP symposium provided the participating Japanese and Canadian scholars with many insights into how each country perceives its own domestic and international policy priorities and constraints as it prepares to enter the 1990s. This introduction provides an overview of the discussion at the symposium and identifies a number of areas where collaborative research would prove to be mutually beneficial to the academic, government and business sectors in both Japan and Canada.

The symposium began by discussing the characteristics of the international economic environment that must be taken into account when defining national and regional priorities as the 21st century approaches. On this, there was very nearly complete agreement. The international context includes:

i) Multi-polarity – Following the relative decline of American and Soviet hegemony, collective responsibility has become essential for harmonious political and economic relations. This implies a larger role for Japan and the European Community (EC), as well as for middle powers such as Canada and China.

ii) The rise of third-world influence led by the newly-industrialized economies, especially of East and South Asia and Latin America. This poses the issue whether these countries will reinforce North-South regionalism—the U.S.A. and the O.A.S.; the EC and the African Associated Overseas Territories (A.O.T.s); and Japan with East and Southeast Asia—or will wider concepts such as Pacific cooperation, including some Latin American countries, cut across these older, somewhat uncomfortable, groupings?

iii) Social and political changes such as arms control and disarmament, the "information revolution", the rapid aging of the populations in industrialized nations, and the growing awareness of the urgent need to implement a strategy that will lead to sustainable development and the protection of the environment, are likely to affect all national priorities. Although these changes can make possible a shift of resources to new, more productive uses, more rapid technology transfer, and a sense of common cause in human society, they require a willingness to discard obsolete ideas, even from the recent past. Global competition should replace many old forms of national regulation, and comprehensive and accessible information systems will be required to lessen short-term instability and to provide the basis for consensus in a longer term "sustainable development" framework.

Against this global context, the symposium proceeded to assess the roles of Canada and Japan individually, and as parts of regional and global systems.

Japanese Perspectives on Japan

Junnosuke Kishida noted that the decline of U.S. and Soviet hegemony has been paralleled by the emergence of Japan as a major actor on the world scene. The recovery of the Japanese economy since 1945, and its remarkable performance since 1960, have been highlights of the last half of the 20th century. That this development has been substantially aided by Japan's relief from a level of military expenditure comparable to its major competitors, while true, is less important than various national characteristics. There can be little doubt that Japanese development has depended on its people, their commitment to individual self-improvement and self-respect, and their loyalty to public and private agents of change.

With the spectacular success of Japan's exports and its accumulation of the world's largest pool of savings, the maintenance of a positive balance in the merchandise account has become, at least for the near future, dependent on the export of capital, as well as some expansion of invisible out-payments. Kishida pointed out that Japan has attempted to sustain an external balance by stimulating domestic consumption, increasing overseas production, adjusting exchange rates and increasing foreign aid.

He also added that Japan needed to make a greater contribution to world peace. Partly as a result of the appreciation of the yen, Japan has now become the fourth largest military power, judged by expenditure. However, Kishida sees other means, such as foreign aid, as equally important methods for contributing to global security. He notes that foreign aid should encompass not only funds, but also liberalization of domestic markets and "reinforcement of technology transfer" through direct investments. Furthermore, he suggested that Japan will also have to play an important role in the revitalization of international organizations.

The "information revolution" is another major element in Japanese thinking about the future. The Japanese scholars noted that increasing emphasis will be given to the merging of different types of technology, and the central importance of software.

Turning to domestic social change, the aging society was introduced by Kishida as an issue that had many important policy implications for Japanese society. The need for new perspectives and institutional arrangements to accommodate the work and leisure needs of older people and the demands that they will place on social security programs, was a theme common to both Canadian and Japanese presentations at the symposium.

Finally, Kishida suggested that an increasingly common attitude that he described as "enlightened self-interest" heralded a changing emphasis from national or corporate priorities to those of individuals. Furthermore, he stated that Japan "must seek to fulfill long-term rather than short-term interests, and must shift from interests limited to itself to those which it holds in common with other nations."

On the basis of Junnosuke Kishida's opening, wide-ranging perspective on the public policy environment in Japan, other Japanese participants expanded on particular policy issues.

The Japanese Economy

Yutuka Kosai provided a statistical description of the structural change that has been taking place in Japan, especially since the appreciation of the yen that began over two years ago. Japan's current account balance declined by about 30 percent from the last quarter of 1986 to the same period in 1987. Manufactured imports jumped by 44 percent in the same period, with Taiwan, Korea and the EC showing the greatest gains; resource-based and labour-intensive industries showed significant losses; and many sectors established productive overseas facilities, for example, cars and electrical goods in North America.

Domestic demand has been stimulated by lower cost imports, easy monetary policy, promotion of housing construction, and fiscal policy measures, mainly expenditure increases. Consumer expenditures increased 10-12 percent on cars and TV sets and 30 percent on VCRs. However, Kosai adds that these changes are greatest for Tokyo, especially the land value changes. The future course of demand will depend on changes in demographic and social forces. Kosai also indicated that tax reform is viewed as necessary to maintain fiscal revenues in the face of a decline in labour force share in the population—possibly requiring greater dependence on consumption taxes.

A special issue in Japan's international economic relations was described by Toru Yano as techno-nationalism. Yano addresses the asymmetry between the U.S. and Japanese views on intellectual property rights that arises out of two features of current U.S. practice: (1) the exclusion of all foreigners, on principle, from any access to scientific know-how that is classified as "military knowledge"; and (2) the requirement that "any

inventions and discoveries achieved in the U.S., regardless of the nationality of the inventor, will belong to the U.S.". The Japanese objection to the first illustrates the significant difference in the amount of resources the two countries assign to research and development with a military purpose and raises the difficult problem of how to draw a line between predominantly military-related technology and that which should be accessible on some terms to civilian industries or for public use. The second problem relates to the key role of Japanese scientists in U.S. labs and presumably of foreign workers in Japanese labs. A recent article in the *Far Eastern Economic Review* (March 31, 1988), indicates that there are more Japanese working in U.S. institutions than American or other foreigners in Japan's R & D establishments. However, it also suggests that, up to now, this can be explained as a matter of choice and is largely a reflection of language difficulties and attitudes. Part of the problem is that many of the best Japanese scientific research establishments are in corporations, where rights of admission to foreigners will likely be governed by rules that differ from firm to firm, based on perceived commercial advantage. The issue is one in which Canadians, as large importers of technology, should be interested in the search for a middle ground, favouring access that also recognizes the necessary rewards for invention and innovation.

Japanese Society and Social Policy

Noriyuki Takayama summarized social change in Japan under five headings: (1) the realization of an affluent society; (2) transition to a low growth economy; (3) aging of the population; (4) changes in the status of women; and (5) changes in the status of older people.

Having perceived the virtual equality of per capita incomes between Japan and North America, the Japanese are becoming dissatisfied with some aspects of their established life styles. Slower growth in real income since 1975 (10 percent) has made workers uneasy about the higher percentage taken from their pay cheques to support the social security system.

Takayama noted that, by 1987, 11 percent of Japan's population was over 65 and have widely varying lifestyles. While a minority have substantial pensions and/or valuable assets (especially real estate), many are adversely affected by the years of limited social security. For younger people, he suggested that the main issues include the lack of housing capital and the difficulty of saving enough to acquire it, and an emerging problem with the "baby boomers" now over 40 years of age whose seniority in Japanese companies is not being matched by their productivity advantage over younger, more recently trained workers.

For Japanese women, employment opportunities are increasing rapidly. By 1985, 70 percent of working age women were gainfully employed. With 60 percent of these women married, much child-rearing is now being shifted to social institutions. However, Takayama noted that approximately one-third of single, aged women are among the poor.

Takayama's discussion of pensions and health care suggests a variety of practice that may be greater than in Canada, although he indicated a convergence seems to be underway. So far as medical-related expenses are concerned, one of the main problems is how to control the living portion of the costs associated with the care of the elderly, which threaten to overwhelm the actual medical treatment costs. Institutional changes in this area appear necessary.

The social policy issues outlined by Takayama highlight the need for rationalization of living-support systems in the pension and medical care systems so that living-cost benefits from the former are not duplicated by the medical care system. He posed questions about various other means of reducing the burden of financial support associated with the aging population, such as the possibility of a more contributory system (or a means test) or an increase in the compulsory retirement age.

Canada-Japan Relations

Canada-Japan relations from the Japanese perspective were addressed by Mikiko Iwasaki. She placed much emphasis on the concept of a North Pacific Triangle, reflecting a characteristic Japanese tendency to consider its relationship to Canada in the context of Japan-U.S. relations. Thus, for example, the Canada-U.S. Free Trade Agreement primarily concerns the Japanese to the extent that it results in trade diversion such as favouring U.S.-based auto companies over Japanese companies. (However, as Yutaka Kosai noted, it is a free trade area, not a customs union, so that the degree of discrimination can be lessened by Canada-Japan bilateral negotiations or within the GATT context.)

Another feature of Canadian trade relations with Japan that was discussed during Iwasaki's presentation to the symposium is the effect of federalism and the role of junior governments in erecting non-tariff barriers. Both Canada-U.S. negotiations and multilateral efforts under GATT have addressed this question, so far with mixed results. Many Canadian participants shared Japanese concerns about the handicaps imposed on Canada's competitiveness by the balkanization of the country through inter-provincial trade barriers. The hope was expressed that bilateral and multilateral trade liberalization measures by the federal government might promote the reduction of internal trade obstacles in Canada, or at least discourage tendencies to extend such barriers.

Canadian Perspectives on Canada

Canada-Japan Economic Relations

Canada's view of the current and prospective international economic environment is very much like that described by the Japanese participants at the symposium. It is dominated by a commitment to a multilateral system conducive to trade and investment flows and to bilateral or regional policies compatible with that system. It is also committed to measures that bring developing countries more fully into the world's economic system by assisting them in financing development and debt management and reduction.

A distinctive feature of the Canadian presentation to the forum was the emphasis on "sustainable development" based on the paper by Jim MacNeill. He noted the commendable record of Japan, which, since 1970, has "allocated a higher proportion of its GNP to restoring its environment and resource base than any other country". MacNeill also pointed out that the Japanese and Canadian governments provided much of the budget of the Brundtland Commission which conducted the recent global enquiry into environment and development issues.

That Commission has demonstrated the urgent need for policies in trade, investment and development that will promote growth compatible with environmental protection. MacNeill quotes a recent statement by the president of the World Bank: "Sustained development depends on managing world resources, not exploiting them. Economic growth based on any other premise is a costly illusion."

Participants in the symposium agreed that the problem is largely one of governability; that is, how to ensure that institutions will direct sufficient attention to these issues. The answer requires changed attitudes and procedures in existing multilateral economic institutions such as the World Bank, IMF, GATT and UNCTAD. In addition, new regional institutions might be required to develop guidelines and practices that governments might will themselves to respect. At the same time, exemplary national practice, such as developing policies for reducing, or even eliminating, river pollution must continue to make a vital contribution.

One topic that stimulated considerable discussion was the role of the market in protecting the environment. It was pointed out by participants that, although market pricing is effective in generating conservation of resources in the energy sector, it is not working in areas such as the preservation of tropical forests or the ozone layer. Several participants noted that its effectiveness depends on whether externalities (e.g., cost of forest practices that leave the land unproductive) can be internalized by redefining property rights. When they cannot, public regulation, often of an international character, becomes necessary.

Canadian Economic Prospects

The Canadian outlook to the end of the century depends heavily on external factors and, in that respect, it differs significantly from the Japanese. However, Japan (through its import and investment policies which play such a major part in sustaining the dynamism of its Asian neighbours, its exchange rate and domestic consumption policies which substantially affect the ability of the United States to restore its international competitive position, and its aid policies which can set a leadership example in the search for debt management and reduction) is obviously an important source of the world's economic health, and as such, is a key factor in the Canadian equation. Nevertheless, Canada's success in the next decade also depends to a great extent on two factors not directly related to Japan: 1) the success of the Canada-U.S. Free Trade Agreement; and 2) the continued strength of commodity markets. Finally, there are two multilateral policy issues on which Canada and Japan cannot by themselves ensure a positive outcome, though they can, and should, play a constructive role. These are the Uruguay Round and developments in world trade policy, and the effort to achieve a compatible pattern of macroeconomic policies in the world's leading economies.

Tom Wilson, in his forecast for Canada, expects the economy to move gradually toward full employment, with a return to inflation and with a gradual reduction in the federal deficit. The new forecast is positively affected by the consequences of free trade with the U.S., which is expected to give a "significant boost to long-term growth through the investment needed for restructuring and through improvements in productivity from industrial rationalization."

The Canadian dollar is expected to stay close to the U.S. dollar. Any thought that it may decline further relative to that dollar seems questionable, as such projections do not take adequate account of rising commodity prices.

Fiscal and monetary policy projections are beset by uncertainties because of the cloudy futures of tax reform and commodity prices. It seems reasonable to expect a declining fiscal deficit as economic growth reduces both the annual debt and debt-servicing costs relative to GNP. Monetary projections based only on short-term inflation and interest rate differentials seem unsatisfactory. The higher assumed Canadian inflation rate is based on records which may be an unsatisfactory guide to the future of a Canadian economy made more competitive, with greater price flexibility as a consequence of the free trade arrangement.

Canada's International Economic Priorities

Murray Smith, in discussing Canada's foreign economic relations, dealt primarily with the linkage between the Canada-U.S. agreement and Canada's multilateral concerns. He asserts that there is no necessary conflict between bilateral and multilateral trade liberalizations. He illustrates this with reference to the implications of the North

American arrangement for Canada-Japan trade and the Uruguay Round of multilateral negotiations.

He notes that Canada's trade with Japan is dominated by the export from Canada of raw materials and the import of manufactures. After years of nominal surplus, Canada's bilateral trade with Japan recently shifted to a nominal deficit position. The value of exports of raw materials dropped mainly because of the declining price of many natural products. Meanwhile the price of Japanese manufactures rose with the yen, but volume held steady for a time because the exporting firms were able to absorb cost increases, given their favourable profit position, notably in the auto sector. Thus Japan's nominal surplus in merchandise trade with Canada was maintained through 1987, but how much longer this will be possible is in doubt since the circumstances favourable to Japan, unrelated to the Canada-U.S. deal, could not be expected to remain in place. In fact, the rise in commodity prices and the need to reflect costs more fully in automobile prices have become increasingly evident.

The Canada-U.S. deal is expected to discriminate against Japanese and in favour of U.S. suppliers so long as Canada charges a significantly higher duty on imports from Japan than from the U.S. The auto trade was singled out as an example where the U.S. might benefit from trade diversion. Smith quotes Paul Wonnacott as pointing out that the Canada-U.S. Auto Pact would have been changed even in the absence of the Canada-U.S. Free Trade Agreement. One feature of the existing scene that was bound to change was the duty remission scheme on imports of parts or materials Canada offered to suppliers from overseas. These have to be removed when present commitments expire, but this does not prevent Canada from reducing or eliminating its duties on parts in the course of the Uruguay Round or as a unilateral action. This example illustrates the flexibility of a free trade arrangement over a customs union, which would require Canada-U.S. concurrence on such changes.

Smith goes on to suggest that in the Uruguay Round it will be in the interest of all three countries to reduce trade barriers so that trade flows can make an appropriate contribution to external balances. Japanese exports of capital may mean that on balance Japan will experience a current account surplus, accompanied by a trade deficit at least with raw-material exporting countries such as Canada. How the U.S. comes out in its bilateral relations with Japan depends on whether, and how soon, further depreciation of the dollar will occur. In any case, it must be clear that trade barriers are not a significant obstacle to the adjustment process. If, as seems possible, the Uruguay Round achieves less than is hoped for it, mainly because of the attitudes of the EC and some countries outside the Pacific region, then there will be both a challenge and an opportunity for the North Pacific Triangle to build a cooperative liberal trade initiative within the region—one that it is in the interest of all concerned to keep open to later adherence by countries now less able or willing to participate.

Canada's Social Policy Priorities

The questions addressed by Shirley Seward focused on immigration and population policy and labour market policies and practices.

Seward notes the historic Canadian debate over optimum population and suggests that, in light of an expected continuing decline in average family size and slower growth of labour force, the emphasis on immigration to meet labour force requirements is the only feasible alternative. Currently immigrants enter both managerial and low-paid jobs, 40 percent are Asian and two-thirds of all immigrants are from developing countries. Immigrants to Canada fall into three streams—skilled workers, family members, and refugees—in approximately a 30:50:20 proportion. In recent years about 4000 of the first group, out of about 4500, have been brought in under the entrepreneurial immigration program, many from Hong Kong.

Canada's refugee policy was also discussed. The recent changes in this policy were viewed by several symposium participants as damaging to Canada's humanitarian image and an over-reaction to exceptional incidents.

Of other labour market issues discussed at the symposium, one of the most interesting in a Canada-Japan context relates to training and retraining, and the implications for the labour market of an aging population and high female participation rates. In both cases, national experience is of mutual interest. For example, the greater use of in-house training in Japanese industry seems to warrant study and perhaps emulation in Canada, particularly in those areas where updating of skills is important and can be productively performed within industry.

Challenges to Canadian Governance

Richard Simeon's presentation to the symposium examined a set of conflicting forces that pose a powerful challenge to governance in Canada. He suggests that, on one hand, global forces demand greater efficiency and competitiveness, which in turn demand responses that seem to "imply a necessary restriction on the forces of democracy" in order to move the polity in the direction of greater coordination and centralization. On the other hand, he notes that newly mobilized domestic forces and groups are demanding greater equity and justice and the political agenda must reflect these demands by emphasizing "increased pluralism, diversity, citizen participation and democracy."

Simeon notes that many of the issues relating to these domestic and international challenges are well illustrated in the debate surrounding the Canada-U.S. Free Trade Agreement and the Meech Lake Accord—the former pushing the nation towards a more authoritative or assertive federal government and the latter towards a more pluralistic society. Achieving a synthesis of these two sets of conflicting values is the challenge to the future of effective governance in Canada.

The degree to which federalism restrains government and threatens governability was raised in the discussion that followed Simeon's presentation. Significantly, there was agreement among participants that political institutions and systems are in the nature of reaction to social forces and are seldom the major reason for particular changes. Richard Simeon agreed with one commentator that the need for supranational bodies (to deal with issues when international action is required to solve widespread social or economic problems) may continue to grow while sub-national forces or loyalties remain strong in areas where national units may be ineffective means for satisfying regional needs.

The theme of appropriate levels and forms of decision-making of governments emerged as a common concern for both Japanese and Canadian participants.

A Research Agenda for the Future

The discussion and conclusions from this symposium made clear the potential value of further collaborative research, possibly involving IRPP and NIRA, or other Canada/Japan linkages.

From a multilateral perspective, this was evident by presentations from both Japanese and Canadian scholars which pointed out how quickly the world is moving down the road of global interdependence. Many of the issues now facing governments transcend national borders: the protection of the environment and the concept of sustainable development; the Uruguay Round and developments in trade policy; the coordination of macroeconomic policy; disarmament, global peace and security; and refugees and immigration are but a few. Effective response to these critical policy issues demands coordinated and cooperative international efforts. It was the consensus of the workshop participants that, although global efforts are necessary to manage and resolve our increasingly interdependent problems, current multinational institutions are by and large incapable of doing so. A crisis of governability therefore makes it incumbent upon us to develop new mechanisms and institutions that can more effectively deal with these issues.

The need for joint Japan/Canada research also results from the increased importance that the two countries have for each other within either a bilateral or regional perspective. With much of the world's economic leadership shifting to the shoulders of Japan, there can be no doubting the need for Canada to strengthen its relationships with that country. On the other hand, with the Canada-U.S. Free Trade Agreement serving as a signpost for increasing North American economic integration, Canada's importance to Japan as an entry to a large continental market for its goods and services is obviously on the rise. However, as was pointed out during the symposium, significant improvement of bilateral relations comes up against a major obstacle, that is, Canada's knowledge of Japanese society, and *vice versa*, is fragmented. The knowledge gap must be bridged and symposia such as this book records are important contributions. However, efforts in this area must be intensified if the two nations are to be brought closer together.

On the basis of this need for joint research, two groups of topics were identified at the conclusion of the symposium. The first focuses on studies of international relationships involving both Canada and Japan, with emphasis on issues in which the two countries have shown evidence of strong and complementary or parallel interest. The second involves comparative studies of Canadian and Japanese social, economic, and political processes and institutions. A brief description of possible topics that fall under the ambit of these groups is presented below to illustrate the dimensions of the need for collaborative research.

One topic that was the focus of considerable discussion was the implication of the Canada-U.S. Free Trade Agreement for Japan-Canada relations and the means of accommodating mutual Canada-Japan interests in the Uruguay Round or by bilateral or regional initiatives. There are obviously a number of avenues that a research project on this topic could follow. Some possibilities include examining the prospect of: full Japanese participation in the Canada-U.S. arrangement; applying to Japan, on a reciprocal basis, a number of the specific provisions of the Canada-U.S. deal (e.g., provisions affecting investment, commercial presence, services, or dispute settlement); a separate bilateral trade arrangement between Canada and Japan; or, the development of regional institutions for greater economic cooperation and coordination in the Pacific region leading perhaps to a Pacific Free Trade Area.

Another topic of international significance from which Japan and Canada could derive substantial benefits would be the study of the feasibility of joint ventures where the two countries have complementary interests. It is likely that these ventures would concentrate on resource development sectors, where Canadian expertise is available and Japan would have a major interest as a market and a source of finance. Such a study would most likely include, as partner(s), China, the resource-rich ASEAN countries and possibly the Siberian region of the U.S.S.R.

Another Canada/Japan initiative might also examine the concept of a "sustainable development" strategy for the renewable resources of the Pacific. Forest resources, studied with the cooperation of Indonesia and Thailand, would be one such possibility.

Finally, the crisis of governability in international institutions, raised in various ways throughout the symposium, would be a research topic with obvious international applications. The focus could be on the structure and processes of institutions such as the World Bank, the United Nations, and GATT to see how well they are suited to managing the economic, environmental, and security issues associated with global interdependence.

A number of topics for comparative study of Japanese and Canadian policy and practices also arose during the course of the symposium.

One of the explanations frequently given for Japan's phenomenal economic success is the high skill levels of its workers. A study that examined education and training practices and how they relate to industrial and technological management and the adaptation of workers to changing technology would be beneficial. Particular focus could be given to the role of in-house training and retraining, the basis in general education for skill development and diffusion, and the role of advanced education systems.

Given the aging of the populations and the increasing rate of female participation in the labour force in both Japan and Canada, it would be useful to examine implications for the labour market. This study could pose questions as to labour market conditions affecting choice between work and retirement of older workers; labour force participation and home or volunteer services for female workers; or, the part-time work option.

A comparative study of the institutional arrangements affecting the development of new industrial technology and means of optimizing the trade-off between reward, or incentive, and openness and the transfer of technology under reasonable and equitable conditions, might also be undertaken by Japanese and Canadian scholars. This would involve the evaluation of existing national practices and policies, and could lead to proposals for improved international practice. Canada—as a traditional net importer of technology which now has aspirations to implement a selective export strategy based on licensing and multinational enterprises—and Japan—now a major exporter of technology—have combined experience that could be of value to international institutions and national policy-makers responsible for the development and administration of intellectual property and other support systems.

Finally, Japanese and Canadian researchers might turn their attention to the question of how political consensus is built in each country. This study might focus on the role of business associations, government-appointed advisory boards, regional associations, consumer groups, labour unions, political parties and other issue-oriented lobbies.

Obviously, a listing such as that above can only be partial. The need for joint research is great and there is no end of suitable topics. It is hoped that this volume will stimulate interest among Canadian researchers in establishing productive and long-term working relations with their Japanese colleagues.

Japan's Tasks in the 1990s

Junnosuke Kishida
Japan Research Institute

Social change has increased in pace and extent. Accordingly, a realistic time frame for an effective forecast is thought to be at most ten years. This is the reason why NIRA has selected the title "Agenda for Japan in the 1990s" when preparing the present comprehensive report on the tasks facing Japan.*

Out of many possible groups of tasks which seemed to have an important bearing on Japan in the 1990s, we have selected 25 main groupings, each centering on a theme. This introduction provides a sketch of these groups, creating a task map. The links among these intricately interwoven groups of tasks are also outlined.

After Hegemony

The "Decline of Pax Americana" is one of the perspectives employed in making the sketch. This means that it is no longer appropriate to view the world in terms of military polarization, i.e., Pax Russo-American. Rather, it has become necessary to look at the world system differently, to put aside a long-sustained view of world order based on stratification under American rule. The new world order may be called the "Era of

---

* Junnosuke Kishida's presentation at the symposium was based on the introductory chapter of NIRA Research Output, *Agenda for Japan in the 1990s*, Vol.1, No.1, 1988. This introductory chapter from that report was co-authored by Junnosuke Kishida, Atsushi Shimokobe, Masatoshi Fukushi and Hiroshi Ohuchi.

Diverse Civilizations", based on the emergence of an age with multiple co-existing civilizations.

Since the latter half of the 1970s, the world has undergone a number of structural changes which have undermined the foundations of the international economic order. The series of events which brought about the changes took place in the following chronological order: 1) a shift in the international currency system to the floating rate system; 2) the rise and fall of OPEC; 3) the problem of cumulative liabilities for developing countries; 4) the stagnation of the Soviet economy; 5) the transformation of the U.S. into a debtor nation; 6) the full-scale entry of China into international society; 7) the emergence of NICs; and 8) the improvement of Japan's status in the international economy.

The "logic" of modern civilization dominated the world during the period from the 19th century to the first half of the present century. As leaders of the industrial revolution, the western nations provided a model for the concept of the modern age, and western civilization enveloped the world as the only modern civilization. Industrialization made progress in the name of modernization, which was in turn often synonymous with westernization.

However, the logic of "modernization = westernization" began to lose its validity in this century. Although westernization led to progress on a worldwide basis in terms of material civilization, Japan's modernization served as evidence that modernization is different from westernization. The emergence of NICs in Asia will probably further support this hypothesis.

Historically and politically, there was a shift from unification to separation from the 19th century, which was to all intents and purposes ruled by a single civilization, to the present century. The total number of nation states, the representative institution in modern civilization, now exceeds 160 as compared with a mere 47 for the entire globe at the beginning of this century.

Moreover, the concept of "nation state" as modern state has begun to lose sway. Many Third World countries have not been able to employ the principle of "unification of the people" in building a nation, due to antagonism among races. Even ideology and religion have declined as forces of unification. Moreover, military strength and technological capacity seem unable to operate as autarchic powers to form a nation.

The control of two superpowers, the U.S. and the Soviet Union, over a polarized world has thus rapidly declined, while multi-polarization has made progress. In order to accurately describe the world system, therefore, it is now necessary to examine closely "the inner structure of the multi-polarized world." This is partly due to the present military paradox centering on nuclear arms. Ironically, the presence of nuclear arms in great quantities has resulted in undermining their links with policy because of their expected destructive capacity.

The 1990s will probably produce a complex structure which cannot be ascertained through simple schemata, such as East-West and North-South relations. The assertion of

tribal and racial identities and their mutual antagonism, the confrontation of religious orders, and international terrorism have begun to undermine the nation state system.

On the other hand, non-government organizations have begun to tackle the problems of refugees, famine and human rights. Such a challenge from the periphery has begun to press for reorganization of states and a change in the content of the international system.

Apart from the emergence of new polarities at the national and block levels, multinational polarities and polarities within new movements have also appeared. Moreover, these polarities compete in a multi-layered field in which military, political, social and cultural powers are interwoven in a complex manner.

In the face of these changes in the international order, in the nature of nation states, and in other components of the old order, existing international organizations such as the United Nations have shown signs of malfunction.

International organizations were originally formed on the premise that independent states are capable of solving problems. When they were founded, the participation of more than 150 states with extreme differentials in capability was not anticipated. Moreover, each organization grew in size and in complexity, producing various disadvantages such as a drop in efficiency and unsatisfactory internal coordination. This has in fact coincided with the decline of Pax Americana. The result has been a return to bilateral diplomacy and the growth of regionalism as well as a financial crisis for international organizations.

It is time that the approach of structuring international organizations to correspond to a multi-polar international order based on pluralistic civilizations was questioned.

Under these circumstances, Japan is expected to fulfill her responsibilities and, appropriate to her new status, play a role as a major non-nuclear power in the 1990s dedicated to the maintenance and restoration of a peaceful world order. Furthermore, Japan is expected to work for the formation of a world concerned with the problems of human rights and humanitarianism as well as with the development of a new international economic system. Japan's new response to international organizations is designed to achieve the stability of East Asia and the Pacific region based on a new global order.

The basis for the development of a post-hegemonic world is the fact that growth goals have to accept the limited size and capacity of the earth. Because man is already stretching the earth's capacities to their limits, it is no longer permissible for major powers to pursue their own selfish interest without first becoming aware of the severe limitation of resources.

Historically, the term "the Seven Seas" was used by Greece and Britain. However, these bodies of water were smaller than what the term implies today. It merely referred to those areas dominated by the two powers. Nowadays the term refers to the entire

globe. It has, thus, become necessary to consider the principle of distribution in a Zero Sum Society; in other words, we now have an irreplaceable earth.

The fact that earth is a spaceship with resource limitations should be taken into account when planning growth and use with regard to the population, food, resources and environment of the world. The physical limits to resources identified by the Club of Rome were gradually overcome through technological progress and the operation of economic principles and therefore do not constitute an immediate crisis. However, there remain important tasks facing us in the 1990s, such as how nations can sustain stable growth and constantly improved life styles; how the international public good can be improved and distributed fairly; and how the cooperation among the advanced nations necessary to the accomplishment of these tasks can be achieved.

Japan as a Major Country

The second perspective to be identified in close relation to the "post-hegemonic" world is the fact that, as Japan has increased her presence on the international scene, her responsibility in international society has also increased, requiring the improvement of her domestic organization as well as a change in its constitution.

In retrospect, the Japanese economy has developed steadily despite the "Nixon shocks", two oil crises, worldwide economic stagnation and the uncertain dollar. Japan's position at the international level has risen markedly in every aspect. Japan's GNP reached 11.8 percent of the world total in 1986. Japan's pace of development has been so fast that the Japanese themselves do not seem to have become fully aware of their increased capacity and role.

The first problem is how to steer the Japanese economy within international society. The world economy is faced with two crises: the problem of cumulative liabilities for developing countries and America's transition to debtor status. The world thus stands at a turning point. If we fail to control the crises of cumulative liabilities and America's economic decline, we may well plunge into a worldwide depression sometime in the 1990s. There is no superpower capable of independently solving these problems. However, despite its declining economic strength, America continues to possess the world's largest economic capacity in terms of scale. Therefore, an important assumption is that America must reconstruct her economy.

On the other hand, we cannot depend on the capacity of one country for the recovery of the world economy. The advanced nations should cooperate to improve the situation. Of all the advanced nations, Japan is the one country that has most increased its capacity for solving these problems.

Japan's capacity as a major nation state will be tested in the 1990s. Urgent tasks required of Japan are to eliminate her trade imbalance with other countries (revealed in a large surplus in her current account), to increase domestic demand, and to change her

economic structure. Japan has also been asked to play a leading role in international society through the further improvement of the Tokyo international money market, internationalization of the yen and contributions to international public good.

The Asia and Pacific region is the focal point for Japan's efforts to foster a structure for a new world economic system beyond the benefits for Japan exclusively.

Historically, the Asia and Pacific region has searched for a framework of cooperation which focuses on the region's economic potential. The region has been able to solidify its independence and break from its former colonial status. As the activities of the NICs suggest, this area has been able to make considerable progress. The expansion of trade in this area points to a rosy future. However, when we look at the region's political systems, we have to accept the fact that there are still many uncertainties, and peace has yet to be achieved.

With the end of World War II, an international system based on solidarity among socialist countries emerged, on the one hand, and another system, in contrast, was created through bilateral security arrangements with the United States. These systems continue to exist. Moreover, the diversity of nations, in terms of population, economic capacity, race and religion, has prevented the creation of a peace structure.

What is needed is a peaceful and open framework of mutual dependence based on a loose solidarity respecting the diversity of the area. If this is successfully formed, the center of the world's gravity will definitely shift to the Asia and Pacific region. Japan has to perform the role of fostering a chain of functional links in this watery region by giving consideration not only to its economic capacity but to technological development and the training of manpower.

What thus distinctly emerges as Japan's most important task is to contribute to peace and security.

Peace is not something which is given; it has to be created. Also, peace cannot be secured by military capacity alone. Peace today should be understood as a broad concept including its relationship with economic and social development; disarmament, including nuclear arms; abolition of racial discrimination, human rights, and exercise of freedom; and improvement in living conditions, including food, housing, health, education, labor and the environment.

To replace the present "small peace" based mainly on a balance in military power, Japan should make a special effort to create a "large peace" by attaching importance to means other than military power. Japan indeed has a mission to achieve a sophisticated, comprehensive concept of security which should be called a "non-nuclear system of security", unlike the security policy based on military power which was developed mainly by the nuclear powers. It is perhaps justified to say that this is possible only in Asia where the concept of peace has not yet been solidified. Japan's creative capacity as a non-nuclear power of the West is now on trial.

One important measure is to contribute to world peace in the form of economic cooperation. Japan already ranks with the United States in foreign aid. However, the

content of such aid should be given close attention. Japan should aim at comprehensive economic cooperation to cover the opening of markets, provision of markets, promotion of investment, promotion of technical transfer, reinforcement and expansion of grassroots cooperation, expansion of multinational cooperation and reform of Japan's industrial structure, instead of centering its assistance in ODA exclusively. It will also be necessary to place emphasis on a multinational approach to foreign aid.

Herein we offer a proposal for a new type of economic cooperation so that Japan may earn praise as a member of the world community. Japan should help developing countries to achieve self-support and self-help, with Japan providing unsparing cooperation as an equal partner.

Expectations placed upon Japan as a major power of the world are large. Japan should pay attention to the criticism that she gives little to others. The idea that it is the responsibility of the state alone to meet the requests of international society should also undergo a change.

There have been many cases among the western nations in which trust among networks of private organizations has proved useful in adjusting the interests of various states amidst increasing mutual dependence. In Japan, the understanding of the role played by such non-governmental organizations as foundations and research organizations is not adequate. What is needed is comprehensive involvement recognizing the role of philanthropy.

Thus, Japan will have to perform her international role and responsibilities within diverse task areas in the 1990s. Ultimately, the promotion of internationalization and the internationalization of the Japanese people are indispensable vehicles for carrying out these tasks.

However, it is by no means easy to press for a change in the awareness of the Japanese people and to open Japanese society to other countries. Modern-day Japanese people have been considerably internationalized by virtue of going abroad for leisure, work and study. Despite the many problems which yet remain, efforts have been made in foreign-language teaching, education for those Japanese children returning home and the internationalization of business management.

On the other hand, more than a few problems remain to be solved in terms of "internal internationalization". For instance, "exclusivity" has not yet been eliminated with regard to the acceptance of foreigners and foreign cultures into the country. There are many problems yet to be resolved with regard to accepting refugees, the nation's response to foreign students, internationalization of higher education and entry of foreigners into Japan's education system and business society. An important and difficult problem is how to resolve these issues from the perspective of internationalization viewed against the traditional unspoken premise that Japan's society is made up of only Japanese.

The Third Industrial Revolution

It is said that the core concept of the first industrial revolution was "material", that of the second, "energy", and that of the third, "information". The advanced nations have now entered into the third industrial revolution.

The greatly improved performance of computers, the development of semiconductor and microelectronic technology, and progress made in optoelectronics has led to remarkable improvements in technology in information-related fields.

Materials, energy and information comprise every phenomenon in the world. Now that technologies for all these components are available, the present period of new technological innovation is one in which development of new materials and energies will, once again, accelerate.

With regard to energy, the "soft" structure of energy will further expand in the form of dispersed power sources or through the parallel supply of thermal and electric power. This is also an age in which diversified fields of technology can be explored by skillfully combining or unifying technologies of various fields. This phenomenon can be seen in the rapid development of mechatronics and optoelectronics. It will naturally lead both to interchanges among businesses and to increased competition, and at the same time play the role of triggering a change in the industrial structure. The increase in the importance of software technology, a marked characteristic of information technology, has served as a factor in the increase of the software aspect of the economy.

Industrial nations are invariably interested in the development of advanced technology as it may lead to the reinvigoration of the economy. Thus, every nation regards research and development in science and technology as an important task. In the case of Japan, it is necessary to improve the system swiftly to meet the need to improve basic research. In fact, the necessity of rapidly increasing the ratio of basic research to overall research capacity seems to be strongly felt by businesses in Japan.

As can be seen in the production of semiconductors, Japan leads the world in the refined processing techniques of mass production. These processes are dependable and cheap. By contrast, however, Japan is still dependent on western nations for most of her needs. The necessary conditions and environment for developing techniques that require a high degree of creativity should be explored. Japan should probably contribute more in the field of basic research. One of the shortcuts to this goal seems to be the establishment of a system of research and development which is open internationally.

As outlined above, the new industrial and social frontiers have never been so widely open as they are currently amidst the third industrial revolution. In particular, biotechnology tends to draw special attention in terms of its potential market size and impact on industry and society. This is probably to be expected in view of the fact that biotechnology is the integration of all component techniques. In Japan, development of a bio-society geared to the exploration and expansion of human frontiers with even wider implications is anticipated.

New frontiers are not necessarily confined to fields of advanced technology such as those referred to above. It is possible that the aging population, women's advance in society, an increase in leisure time, and greater individualism and self assertion may create new markets. A parallel relationship between making and using, for example, a "prosumer" society synthesizing producer and consumer, has begun to emerge.

Technological progress and the exploration of new markets naturally changes the shape of business and industrial structures. If it is true that those industries with higher information content are wealthier, then they should be valued more highly. A difference in design can result in a difference in value even if there is no difference in function. Thus, software is more valuable than hardware. The future, the software-oriented economy and intra-company society, has already begun to appear. In those businesses leading to software applications, employment and personnel practices are no longer of the traditional type based on lifetime employment and seniority. With the adoption of a merit system, Japanese employment practices have begun to show signs of disintegration.

The increasingly software-oriented economy is forcing Japanese business to change its image for the future. However, the change will not stop there. International expansion of businesses will make further progress. Internationalization in every aspect (finance, organization and personnel) will proceed, turning some businesses into transnational businesses in character.

The advancing new industrial revolution will create various problems in people's lives. Many new media will be used in the advanced information society. People will have access to new types of media, such as personal computer communication networks. Personal computer communications, capable of communicating with a large number of partners across space and time, offer new possibilities.

At the same time, however, the development of an information society poses new problems for society. These may be called the environmental problems of an information-oriented society. Just as the development of industrial society led to the pollution and destruction of the natural environment, this new condition will disturb man's social environment. The list of problems relating to the development of an information-oriented society is long and includes the protection of privacy and the public release of information.

Trial and error will probably continue in the 1990s, centering on the theme of the "information-oriented society and people".

Another phenomenon in this period of technological innovation which should not be overlooked is the effect of the development of advanced technology on international relations. It seems necessary to watch carefully, from the perspective of international politics, various developments which are taking place in the course of the third industrial revolution. Some examples of the new influence of the development of science and technology on international society are the connections between the stationary satellites in orbit over the equator and the development of satellite technology in various countries, marine development technology and a new international marine law, and the Antarctic Agreement and development.

In an Aging Society

Until recently, the average life expectancy of the Japanese was 50. With a higher standard of living, an improved social security system and the development of medical and health care, it has risen to 80. The life style of the aged and the social system which is supposed to sustain it have not been able to fully cope with the pace of change. Unfortunately, many people are not enjoying pleasure and affluence after reaching the world's top rung on the longevity ladder.

To put it rather dramatically, the theme of senility and health in an aging society are research themes which have never been fully explored in human history. There has been no record of such a large population forming a society with an average life expectancy of 80. Various means that can facilitate the prevention of senility, promote self-care and mutual help at the neighborhood level, and encourage employment of the aged are thus needed so that the elderly, together with other generations, can stay healthy and live as long as possible.

The development of an aging society points to the need for a new perspective regarding the problems concerned with the family and home. The family and home make up the principal component group of society. Men and women produce children by sexual intercourse. With this phenomenon or fact as the core, blood relations, territorial relations and other similar relations form groups. This is the family.

As the number of children has decreased, the Japanese family and home have changed their role and functions. Moreover, there has been an increase in the number of those persons who fall outside the parameters of the traditional concept of family such as those not wishing to be married, those advocating free relationships between men and women, those who are either divorced or separated, and those persons who become single by virtue of the aging process. The family has thus acquired a diverse character.

This has greatly affected child care, the roles assigned to husband and wife, their traditional life styles, and conventions concerning inheritance. Changes in the economic and social environment for women also pose important challenges for the Japan of the 1990s.

The International Women's Year and the United Nations Decade for Women provided an opportunity to enact the Law for Equal Employment Opportunities for Men and Women in Japan. Assessments of its effects are still divided. However, many Japanese have developed a critical view of their life style. The impact of this development has been significant for men.

The future of women and their new image of life, not only in the work-place but also in the educational and cultural spheres of activity as well as at home, deserves close scrutiny.

It is indispensable for an aging society to create a social framework in which people can study at their own initiative throughout their life. This lifelong education is a system of providing opportunities which aims at independence. We live in a society in which learning should not be the exclusive occupation of our student days. The framework for

lifelong education should be able to meet the wide-ranging needs for learning such as learning about one's regional community as a citizen; professional education; international education as a world citizen; and general education as a citizen of the country, as a family member and as an individual. This leads to the reinvigoration of the community through healthbuilding, economic and professional independence and voluntary learning. New communication capacities, the reinvigoration of home education, and learning about the life-styles and problems of mankind should also be included in a program for lifelong education.

Maturity and Affluence of Society

The effects of the various changes outlined above on Japanese society can perhaps be best expressed as maturation amidst increasing affluence.

What repercussions will it have on Japan's political structure? In general, it is undeniable that the people's interest in politics has vacillated and become unstable. As distinctions between the traditional farmer and the urban citizen have blurred, the emergence of an immense stratum of those with a middle-class consciousness has made it difficult to ascertain the popular will. They either change their voting behavior or abstain from voting, depending on the point at issue. Is this perhaps an unavoidable phenomenon brought about by the stabilization of the patterns of living?

The Liberal Democratic Party has stayed in power as a "catch-all party" (addressing itself to everyone) since 1955 when it was formed as a result of "conservative unification". Within the party itself, factions have played the role of checking each other's influence while maintaining a power balance. The party has been able to stay in power over a long period of time because it addressed itself to everyone's needs and also because of interfactional rivalry.

In contrast, the LDP's long rule has brought about a marked increase in hereditary Diet members and "tribal" Diet members or Zokugiin. While this may contribute to the stability of the party from the viewpoint of continuity, it has also been an undeniably negative factor in that it produces tenacity of vested interests and rigidity in policy. How will the party achieve the foresight, leadership and power of execution that are expected of its policies in the 1990s? It is time that an accounting was taken of its long rule.

Like the unclear view people hold of politics, the yardstick for value judgement has constantly changed in assessing the quality of life. In fact, people have begun using more than one yardstick. In short, "self-oriented self-improvement" is expected to be the central feature of the quality of life for Japanese in the 1990s. Apart from their orientation toward relaxation, voluntary simplicity and a high quality of life, a multiple personality, the solo life and the principle of "living in the present" are likely to serve as the key identifying words of the affluent society.

The young are always flexible. They respond flexibly to social development. They skillfully incorporate new technology into their lives. There is the possibility of creating a new youth culture. Technological progress has given them the means to create and use their own inventions. For instance, progress in printing techniques has made it possible to produce little comic books without difficulty. The development of the synthesizer and its gradual price reduction have made it possible to perform or compose music. Visual creation is no longer remote to junior and high school students, as video and still cameras are available at low prices. Such developments are taking place in every field.

Close attention should be paid to the style of thinking and the behavior of the young as phenomena which are precedent-setting for Japanese society in the 1990s. In contrast to the creation of culture by the young, however, the school community has deteriorated, with colleges turning into leisure play-lands. It is probably no exaggeration to say that the present school community spawns conformist students through its monistic grading practices which destroy the young people's belief in "possibilities" and produce dropouts.

What is happening to the city as a place for people to live amidst a society in the process of maturation and increasing affluence? The way Japanese people live has been based on an urban division of labor and a cooperative attitude toward living in cities which were regarded as a place of production and not built to provide a pleasant living environment. Large and small, cosmopolitan and provincial, Japan's cities together account for more than 70 percent of her total population. Long regarded as the place of production, Japanese cities have been slow to improve living conditions. However, urban citizens within a mature and affluent society want cities that are conducive to everyday living, and are demanding an improvement in social capital.

Moreover, the cities will be linked by advanced transportation, information and communication networks in the 21st century. With an advanced communication network, the relationship between time and distance will cease to be a major problem in the future urban society. Even the distinction or confrontation between agrarian and urban areas, between work and home or between day and night may be overcome. The network will be employed to secure a good living environment, individualistic cities and international interfaces. Hopefully, these cities will form a society in which various values can coexist in a spirit of solidarity.

Aiming at "Enlightened Self-Interest"

Japan already accounts for more than one-tenth of the world's total production, and Japanese products with advanced processing are in use in every corner of the world. Having established her position as a capital-supplying nation, Japan has come to possess the most up-to-date technological capacity.

It was during the process of such growth that Japan's frictions with other countries developed. Japan has not been able to cope with them appropriately due to drastic

changes both at home and abroad and to the development of complex mutual interdependence. The 1990s will be an age in which Japan must learn ways to live wisely with frictions.

The attitude required of us in dealing with the various tasks outlined in this report may be expressed as one of "enlightened self-interest". Both individuals and states pursue their own interests. However, to deal with its tasks Japan must expand both the time and space dimensions of the concept of self-interest or self-benefit. That is, it must seek fulfilling long-term rather than short-term interests, and must shift from interests limited to itself to those which it holds in common with other nations and which cover a broader range.

Japan's tasks in the service of its national self-interest should be identical to those efforts for solving world problems. The solution of each problem will have to be implemented as a joint undertaking with fellow world citizens who have problem-solving capabilities.

We feel strongly that the central problem for Japan in the 1990s will be to find once again a way to realize its "enlightened self-interest".

Comments

Rod Dobell

In areas such as ODA, liberalization of domestic markets and technology transfer, Japan's contributions to international peace and security have clearly intensified in recent years. But I am struck by the argument that Japan's military expenditures are also large and growing rapidly. I would be interested to hear your views on the likelihood that this emphasis on military expenditures, as a contribution to global peace and security, will continue to be a policy of Japan's government.

Junnosuke Kishida

I feel that this tendency will continue for the immediate future because of strong pressure by the U.S. to do so. Henry Kissinger recently remarked that eventually Japan's military expenditures will approach 2 percent of GNP. Some people in the U.S. and in Asia are worried about this growth, but I don't think that it will happen too soon, although expenditures will continue to increase gradually.

Atsushi Shimokobe

I agree with Dr. Kishida's assessment regarding the increase of Japan's military expenditures because of the U.S. fiscal deficit problem. According to the United States,

the defense budget that it used to spend to defend Japan, should now be shouldered by Japan. Furthermore, because of the trade surplus situation between Japan and the U.S., and the political negotiations that revolve around it, Japan may be pressured into buying U.S. military products. This will put Japan into a difficult position because the Japanese people have traditionally resisted increases in the country's military budget.

Shirley Seward

Is there concern that Japan's aging labour force will make it more difficult for the successful completion of some of the economic transformations that you discussed? Also, you mentioned the need for life-long education and training, but is the labour force sufficiently flexible and adaptable to take advantage of such training?

Junnosuke Kishida

Professor Takayama will deal with these issues more concretely, but I would like to quote one figure. In 1985, Japan's population over the age of 65 was 10.2 percent of the total population, but by the year 2000 it will increase to 16 percent. It is hard to imagine that no one over the age of 65 will work. Social planning will have to take into consideration the reality of elderly workers and the type of work they do. The objective of why they work will not be limited to economic survival. For example, the kind of work they do might include some kind of volunteer work. Life-long education will be one more necessary and significant factor of an aging society.

Noriyuki Takayama

In most cases, the compulsory retirement age for men employed by private corporations is 60 years old, at which time they become eligible for pensions. Despite the fact that retirement starts at 60, people of that age still participate in the labour force, although there is a move to change the legal system to institutionalize this compulsory retirement age. However, the aged's participation in the labour market is constantly decreasing. Even though their increased participation is much talked about, in reality, they are expected to retire and live on their pensions, and most of them do so because of the adequacy of the pension. Nevertheless, those people who want to work into their 60s or 70s should be provided with a suitable environment.

To respond to your question about the flexibility of the labour force, according to management, the corporate rewards for training are greater for the young than for the middle-aged or elderly. Therefore, management is reluctant to provide training for all of its workforce and it is very difficult for all but the young to acquire new types of work skills in Japanese society.

Atsushi Shimokobe

Compared with other countries the labour participation rate of Japan's elderly people is high, partially because welfare measures for aged people are not so good. The country's current efforts to improve the welfare system should help to explain decreases in the participation rate of the elderly workers.

Thomas Shoyama

I was interested in your discussion of Japan's trade surpluses and in the notion that this situation has historical precedents. This suggests that there might be some support for the view that explains Japan's rapid economic growth in terms of conventional or even classical economic models. That is, the notion that the Japanese economy has grown so rapidly because it is in the process of catching up to the more advanced economies in Europe and the U.S. If this is true, then one anticipates some slowing in the growth rate of Japan's economy. The competing theory that is often advanced is that there have been unique factors in Japan's economic growth, such as cultural factors not found in western democracies. Does your research lead you to any conclusions on this? Has rapid economic growth been a matter of following classic models of catch-up, leading to slowdown? Or, in fact, are there rather unique factors that help to explain the growth, and if so, will they continue in the future?

Yutaka Kosai

Japan's high economic growth rate is, in one sense, a process of catch-up. Right now the growth rate, which used to be 10 percent in the 1960s, is 3-5 percent, so the catch-up process seems to have largely come to an end. But, still, Japan's economic growth is high compared to western industrial countries. This growth is supported by high saving and investment ratios which may be explained by cultural as well as economic reasons. The cultural factors for economic growth may also include the relatively high average educational background of Japanese blue collar workers.

Jim MacNeill

Have you examined the question of Japan's aging society in the context of the growing youthful society that surrounds your country? With 50 percent of the world's population under the age of 25, global society has never been younger (this is particularly true in Southeast Asia). What does this say about tensions between rich, aging societies and poor, youthful societies, living side by side and linked by modern communications?

My second question has to do with security issues. Has Japan considered the concepts of security and threats to it within a broader concept? You refer to military threats to security, but there are also types of threats, for example there are economic

threats such as your dependence on resources and energy from areas that tend to be politically unstable, and also environmental threats.

Atsushi Shimokobe

Threats to security will increase and become more diverse as human activities become more diversified. The threat to the environment and access to resources are an example of the type of non-military threat to security faced by Japan and other countries. But it is not recommendable for every nation to apply the same model of response. For example, non-nuclear powers or countries with few natural resources must predicate their security arrangements on stable mutual dependence. This makes them quite different from countries that have nuclear weapons or an abundance of natural resources.

With regards to your question about the relationship between the aging societies in developed nations and the ever-more youthful societies of developing nations, I would like to point out that the young people in these two situations cannot be talked about on the same terms. They are quite different. Japanese youth are not increasing in numbers so their pressures are not explicitly felt. But the changes and diversification in their lifestyles is self-evident and various observations are made in our research to that effect. Communications within the same generation have come to have a different structure than in the past and the interests that individual young persons have, and the way they pursue them, has also become very different. For example, access to high-tech, specialized devices for pleasure and creative activities has become so democratized that youth can engage in a number of activities, such as publishing magazines or engaging in a personal computer networking, at very low costs. In addition, in Japan we have what we call the "Tokyo problem". Tokyo is a megalopolis, with 30 million people living in its greater metropolitan area. This is a highly artificial urban environment and emerging from it are groups of young people that we call the "new breeds". These "new breeds" have quite distinctive mental and semantic characteristics and their presence exacerbates an already wide generation gap. In the future, what will happen to this gap is highly unpredictable.

I would like to comment briefly on the other point that you made about the rapid growth of young people in the developing regions of Pacific Asia. In its past Japan experienced a period when the number of Japanese children increased very rapidly and, at that time, an educational system that was insufficient to cope with this growth was a big problem. What I worry about for developing, youthful societies is the seeming inevitability, and all of its consequences, of high illiteracy rates.

Structural Change in the Japanese Economy

Yutaka Kosai
Japan Economic Research Centre

In February 1985, the Japanese yen stood at approximately 260 to the U.S. dollar. By March 1988, the rate had shot up to 130 yen. In other words, during the past three years, the yen's value has doubled in relation to the U.S. dollar. The yen's sharp appreciation has had a significant impact on the Japanese economy, and structural adjustments are now taking place at a faster pace than expected, for example, by the Maekawa Report.[1] In the following paper, I will present my views on these adjustments and their significance.

Changes in Balance of Payments/Trade Structure

As a result of a slowdown in exports and a steep increase in imports, Japan's current account surpluses have been reduced. The balance of payments surplus on the current account for October-December 1986 was 15.6 trillion yen (on a seasonally adjusted basis) which accounted for 4.7 percent of the GNP. For the same period in the following year, the surplus plunged by 29 percent to 11.1 trillion yen, or 3.1 percent of GNP. Although this year-on-year decline in current account surpluses was substantial, on a dollar basis, the decrease was considerably smaller due to the greenback's falling value. Nevertheless, there is clearly a downward trend.

Notable in Japan's balance of payments picture is the growing importation of manufactured products. In 1975, manufactured goods made up a relatively small part of the country's imports, with foods and raw materials accounting for 80 percent of the total. However, by 1987, manufactured products occupied 45 percent of Japan's overseas

purchases. For the period October-December 1987, manufactured imports jumped 44 percent over the corresponding period of the preceding year.

This growing importation of manufactured products has brought about drastic changes in Japan's trade structure, which has in the past, as a result of Japan being the only fully industrialized nation in Asia, centered on processing trade—that is, vertical, international division of labour. Japan's trade structure has therefore been quite different from that of other industrialized nations, which generally feature intra-industry division of labour, or horizontal, international division of labour. Accordingly, Japan has tended to be internationally isolated, since it has provided meagre markets for the products of industrialized or developing nations. However, this situation has now changed. Amid the yen's appreciation and rising income levels, trade with EC nations is swelling (as shown by the sizable increase in imports of German automobiles, such as Mercedes-Benz and BMW), and two-way trade with newly industrializing nations, including South Korea and Taiwan, is on the rise. Remarkable growth is being seen in the import of household appliances and other industrial products. At the same time, in its recent trade with the United States, Japan's exports have been sluggish, whereas imports have shown an upward trend.

Table 1
Recent Trends in Japan's Exports and Imports
(Year-to-year comparison, %)

	Exports from Japan		
	87/Oct-Dec	88/Jan	88/Feb
Total (U.S. dollars)	13.0	15.8	17.2
U.S.	5.6	4.2	9.7
EC	28.9	22.7	22.8
South Korea	20.3	20.4	22.4
Taiwan	35.0	45.6	27.7
Total (yen)	-1.9	-7.7	-1.4
	Imports into Japan		
	87/Oct-Dec	88/Jan	88/Feb
Total (U.S. dollars)	34.5	34.4	48.0
U.S.	24.7	23.9	51.9
EC	18.6	31.2	61.3
South Korea	50.9	63.2	73.8
Taiwan	42.6	39.6	72.3
Total (yen)	17.2	6.5	24.6

Source: Ministry of Finance Trade Statistics

The growing weight of manufactured products in Japan's imports, and the resultant horizontal, international division of labour with its trading partners, has the effect of promoting Japan's economic exchanges and relationships with other industrial nations. Specifically, from a long-term perspective, the upswing in purchases of manufactured goods is expected to facilitate the elasticity of Japan's import income and correct the balance of payments position.

Income elasticity for imports of natural resources, energy and foods is generally low as, since the oil crisis in the 1970s, a trend of energy and resource conservation has taken hold. For example, Japan's current GNP is 8.5 percent higher and its oil imports are 20 percent lower than in 1973. As long as natural resources and energy constitute the main items of Japan's imports, economic growth will not boost imports and lead to an upward trend of balance of payments surpluses. Meanwhile, income elasticity of imports is high for manufactured products and this means that the more imports of manufactured goods grow, the more purchases of raw materials decline, the higher the income elasticity of imports becomes.

The 1987 Ministry of International Trade and Industry (MITI) study on trade and commerce[2] estimates income elasticity of manufactured goods imports at 1.6, and that of raw material imports at 0.15–0.30. When the ratio of imports is 20 percent manufactured goods and 80 percent raw materials, the overall income elasticity is 0.50. With a 50/50 percent ratio, the income elasticity grows to around 1.00.

Industrial Adjustments and Measures Taken by Companies

At the same time changes are being seen in Japan's balance of payments position and trade structure, industrial adjustments are occurring as companies implement measures to cope with the yen's appreciation.

Due to the yen's rising value, a number of comparatively weak industries have run into difficulties and have either disappeared or undergone severe streamlining. Hardest hit have been industries which are dependent on domestic natural resources. The aluminum smelting industry, which relies on the generation of hydroelectric power, has vanished; the once key industry of coal mining is on the verge of extinction; and many non-metal mines have been closed.

Labour-intensive industries have also been hard hit. Because the yen's appreciation has boosted the competitiveness of the dollar, or other currency-based wages, Japanese labour intensive industries have lost their international competitive edge. Shipbuilding, once a major export industry, has lost its competition with South Korea and other newly industrializing nations in the world market and has been forced to branch out into other areas; the steel industry has carried out large-scale personnel retrenchment in order to reduce labour costs and has also moved to diversify into other fields; and the textile industries have been in the process of adjustment for a long time.

Future industrial adjustments are also expected for advanced exporting industries. The electronic, electric, and automobile industries have set up manufacturing plants overseas to fight off the yen's appreciation and protect themselves from protectionism (frequently in the form of voluntary export controls). When these overseas plants go into full operation, their products are expected to either replace other countries' imports from Japan, or will be actually marketed in Japan itself. (Japan's growing imports of electronic and electric goods are partly attributed to this boomerang effect.) The production capacity of Japanese automobile plants now under construction in North America is close to the current number of car exports from Japan to the United States. Ironically, there is a great possibility that cars to be manufactured in these plants will be exported to Japan at the same time that car imports from Japan will be restricted.

Sheltered industries, such as agriculture, may also face adjustments. But this depends on how domestic restrictions are to be lifted and the extent that Japanese markets will be opened to foreign countries.

With this industrial adjustment taking place, companies have also taken other measures against the yen's appreciation. Among them are rationalization to lower costs, increasing overseas procurement of parts, establishment of overseas manufacturing footholds, and exploration of markets to accompany the shift to domestic demand-led growth.

So far, cost-reducing efforts have produced favourable results and, despite the yen's appreciation, corporate profits picked up in 1987. Export-oriented industries have turned to domestic markets buttressed by the booming demand for such durable goods as passenger cars and VCRs. Japanese industry seems to have successfully fought off the yen's appreciation and maintained its economic dynamism.

Expansion of Domestic Demand: Quest for New Riches

Growing imports, and progress in industrial adjustments, has the potential to reduce employment opportunities and boost unemployment. In early 1987, when Japan's unemployment rate exceeded 3 percent, many experts expressed fear that Japan was entering an age of high unemployment. However, this fear was alleviated as the country's jobless rate subsequently turned downward.

Despite increasing imports of manufactured goods and industrial adjustment, the employment situation has not deteriorated. Instead, it has improved. Expanding domestic demand has more than offset the adverse effects of growing imports and industrial adjustments. Domestic demand in the latter half of 1987 showed outstanding annual growth of 7.8 percent.

What has brought about this stimulation of domestic demand? In macroeconomic terms, the yen's appreciation has improved the terms of trade, stabilized prices and boosted real buying power. For example, if Japan's imports stand at approximately 100

billion dollars and the yen's exchange rate doubles to 130 against the U.S. dollar, the profits accruing from the yen's appreciation will amount to 13 trillion yen (100 billion yen multiplied by 130). Purchasing power of this scale has resulted a massive stimulus to domestic demand.

A second contributing factor is the government's easy monetary policy. In order to slow down the yen's appreciation and prevent the economy from entering into a recession, the government has carried out credit relaxation measures and lowered interest rates to the lowest level in history. Declining interest rates have stimulated consumption expenditures, housing construction and equipment investment by small enterprises, both directly and indirectly through "assets effects" of rising asset value (land and share prices).

A third factor is the positive effect of Japan's fiscal policy. Despite government plans to reconstruct public finance aimed at wiping out budget deficits by 1990, active fiscal measures were carried out to prevent outbreak of recession. In the autumn of 1986, the economic emergency measures, amounting to 3 trillion yen were carried out, and were followed by a 6 trillion yen fiscal mobilization.

As reasons for the expansion in domestic demand, classical economists would stress the improvement of the terms of trade; monetarists, the ease of monetary policy; and Keynesians, the active fiscal policy. The reality, however, is that it has been the combination of the three factors that has boosted domestic demand in Japan.

Actual consumption and housing investment has shown robust growth and has in fact far surpassed government expectations. Several years ago, the feeling that that domestic markets had already reached the saturation point, because of the wide use of durable consumer goods as well as the expectation that rising land prices would hamper housing construction, gained acceptance. That did not turn out to be the case and housing starts reached the annual rate of 1.8 million units for October-December 1987. During that quarter, department store sales increased 6.2 percent over the same period for the previous year; new car registrations, 10.1 percent; domestic shipments of VCRs, 30.1 percent; and overseas tours, 22.3 percent. Given these figures, the market saturation theory is considered groundless. Rather, the Japanese have now moved to pursue new standard of richness in the wake of the yen's appreciation.

Of course, we should not be overly optimistic about the expansion of domestic demand for several reasons. First, stimulation of domestic demand is speculative and transient as long as expansion is based on speculative growth in land and share prices. The 1.8 million unit level of housing starts is relatively high, considering that the level for the U.S., with a population twice as large as that of Japan, was only 1.6 million units, and housing starts in recent months have dropped to the annual rate of 1.7 million units. The second cautionary note is the pronounced imbalance in income distribution and regional development. Rising land and share prices have widened unfair distribution of income and assets. Housing starts and consumption have tended to be concentrated in the Tokyo area, whereas business activity in other areas is not brisk.

Despite these caveats, the recent expansion of domestic demand in Japan is not unsettled or rootless. The rise in asset values, does include some speculative factors, but is largely reflected in declining interest rates. Japan's long-term rates stand at 4 to 5 percent, compared to 7 to 8 percent several years ago. As Japan has become a capital exporting nation, its interest rates will naturally drop to the lowest in the world, with a favourable factor of price stability, thanks to the yen's appreciation. Therefore, it is reasonable to conclude that it is the falling interest rates, not speculation, that is mainly responsible for boosting asset values.

It is also notable that the land value spiral has occurred only in Tokyo. This is attributed to regional gaps in economic activity and the supply-demand situation of land. In Tokyo, which has developed into a worldwide financial centre, demand for office space is growing substantially. In sharp contrast, demand for land in the regions is much less, as a result of such factors as: government restrictions on the planting of rice because of excess supply (one-fourth of rice paddies are now left idle); and the closure of heavy industry plants in the Pacific coastal belt zone. Given these circumstances, "balanced use of national land" is all the more important as a government policy. The Fourth Comprehensive National Development Plan and the "furusato (hometown) creation" concept proposed by Prime Minister Takeshita are closely related to this policy.

Long-term measures are clearly needed to solve gaps between Tokyo and local regions and public projects to stimulate domestic demand should be carried out constantly over a long term. But, in a sense, the existence of an imbalance serves to create new development in a bid to correct the imbalance. It takes time to fully solve deep-rooted regional gaps but, in the short-term, economic growth, supported by expanding domestic demand, has spread to local districts and helped correct the problem. For instance, while regional gaps in department stores sales and housing starts were quite distinct last summer, the gap is currently diminishing. The growth in regional economic activity is chiefly ascribed to increased public investment by the government.

The view that the expansion of domestic demand is supported by temporary as well as sustaining factors is based on the strong recovery in capital spending by the private sector, including manufacturing industries, in the latter half of 1987. The pick up in manufacturing industries is especially outstanding in domestic demand-oriented industries such as pulp and paper and foods. In addition, the steel and electric industries which are normally considered export-oriented, are now ready to launch investments based on a successful shift to domestic demand. Growing equipment investment to stimulate domestic demand reflects the confidence private industries have in its sustained expansion. It should also be noted that establishment of plants by domestic demand-oriented industries outside the metropolitan Tokyo area is contributing to business growth in local districts and a narrowing of the gap with Tokyo.

Table 2
Changes in Gross National Expenditure
(annual rates after seasonal adjustment)

	FY84	FY85	FY86	FY87/I	/II	/III
Private final consumption	2.6	2.8	3.6	2.7	4.2	1.8
Private housing investment	0.5	2.9	10.9	12.5	47.4	60.3
Private equipment investment	11.5	13.2	4.5	7.3	11.2	17.4
Public capital formation	-2.9	-6.3	6.6	6.9	12.8	29.3
Exports and others	15.6	2.1	-3.6	-7.2	29.6	-6.5
Imports and others	9.8	-2.3	5.5	3.3	27.2	9.7
GNE	5.1	4.4	2.6	0.0	8.4	7.0

Source: Economic Planning Agency, Report on National Economic Accounts

Table 3
Trends in Private Equipment Investment Plans
(Year-to-year comparison, %)

	1987	1988
All industries	6.0	6.7
Manufacturing industries	-0.2	9.8
Electric	5.0	13.8
Automobile	-7.3	4.4
Steel	-25.2	3.2
Chemical	3.8	9.6
Foods	14.1	19.8
Paper-pulp	17.8	23.2
Electricity	-2.0	-0.4
Retail	25.7	11.3
Service	21.7	13.2
Lease	29.0	14.2

Survey by Japan Development Bank in February 1987.

Public Finance Reconstruction: From Persistent Imbalance to Expanding Equilibrium

The emergency economic package in the fall of 1986 and stimulative fiscal policy in the spring of 1987, helped to expand domestic demand. Active fiscal policy has resulted in favourable financial conditions, making it practical to achieve the goal of public finance reconstruction (to wipe out budget deficits by 1990), which until recently was considered impossible. Indeed, Japan's imbalance in public finances is now diminishing.

Japan is achieving this objective by pursuing stimulative fiscal measures. Of course, other strategies could have been adopted. It could have attempted to restore balance by belt-tightening policies, but it is likely that such a strategy would have slowed down economic growth and reduced tax revenues, which in turn would have left the imbalance uncorrected. Alternatively, private industries could have boosted exports in order to escape the effects of recession, but this undoubtedly would have further expanded the imbalance with trading partners. Instead, the stimulative fiscal policy has increased tax revenues and helped improve public finances for the past couple of years. In short, expanding equilibrium is well under way.

The main reason for public finance improvement is growing tax revenues. Since April 1987, monthly national tax revenues have shown a year-to-year increase of more than 10 percent and corporate taxes have witnessed a rise of 20 percent. A second reason is the sale of Nippon Telephone and Telegraph stocks after its privatization. A third is declining interest rates, which lower interest rates for government bonds. And a final reason is the improvement of the public finances of local governments, which reduces national government subsidies to them. The overall improvement of public finances has helped to boost confidence in sustained expansion of domestic demand.

However, once again, some caution is warranted. Some of the factors that have helped to improve public finances are temporary. Growing tax revenues include increases in securities transactions, inheritance and real estate taxes (reflecting the booming stock market and skyrocketing land prices). Increased revenues from corporate taxes also include growing profits from financial speculation and the yen's appreciation. Meanwhile, the accumulated debts of the former Japanese National Railways remain unresolved.

The government is concerned that peoples' dissatisfaction with the present tax system be eliminated by the introduction of broader tax brackets. Out of this consideration, the government has set forth tax reform as an important policy, with the focal point being the introduction of a large-scale indirect tax.

The political situation surrounding tax reform is unpredictable. It is certain, however, that the proposed tax reform is not designed to reduce budget deficits, given the current improvement in public finances. It is not important to raise tax revenues quickly and, indeed, if necessary, substantial cuts in income tax may precede tax reform. But it is important that the tax system be revised to secure long-term revenues. A very significant long-term consideration is the need to strengthen the country's fiscal foundation in order to cope with the greying of society toward the 21st century. The current social security

systems, despite some reforms, are not based on a sound long-term fiscal foundation. The aging population is expected to boost the cost of pensions and medical expenses, which may put future public finances into the red. To deal with the aging population, it is desirable to construct infrastructures for the future social foundation now, when the labour force is large and savings rates are high. Preparation for a future aged population is not contradictory to active fiscal policies to expand domestic demand.

To Restore Balance in the World Economy

Amid the yen's appreciation after 1985, domestic demand is expanding and imports are growing in Japan. Private industries are retaining their vitality and public finances are moving toward an expanded equilibrium. The growing budget deficits and waning industrial vitality seen in the U.S. economy in the early 1980s have not occurred in Japan.

Structural changes in the Japanese economy, economic growth led by domestic demand, and expansion of imports are expected to contribute to restoring balance in the world economy. While the Japanese economy is growing with the stimulation of domestic demand, on the other side of the Pacific the United States is increasing its exports. This reversal of the roles of the economic powers has long been awaited to restore balance in the world economy. Despite "Black Monday" in the fall of 1987, hopes are growing for improvement of the world economy. However, the restoration of balance is not assured. In order to reduce Japan's trade surplus with the United States its imports must grow much faster than exports and the U.S. must boost its exports much more than imports. Currently, U.S. exports are swelling, but imports are also on the rise. U.S. exports for October–December 1987 leaped 24.5 percent over the same period of the previous year, while imports surged 14.1 percent. As the volume of imports is 1.6 times higher than that of exports, export growth in this range makes little contribution to reducing the trade deficit. It is obviously desirable for the United States to lower its volume of imports. The problem is that a decline in imports by such an economic superpower as the United States may contract the world market and eventually stem the growth of exports from the United States. In addition, trade deficits and profits mean future interest payments and receipt of interest, which will widen the current account imbalance. In order to reduce current account deficits, it is necessary to correct the trade imbalance.

Views are split over whether a further appreciation of the yen and decline of the dollar are needed for this adjustment. Some say that the current exchange rates have been fully adjusted in view of purchasing power parity and that the trend toward balance will continue under the current rates, given the boomerang effect of overseas direct investment in the future. (In this case, currency adjustments of NICs is necessary.) However, considering the fact that current account deficits remain big, thereby boosting debts, it is not proper to fix the exchange rates at the current levels. Unstable factors may continue to affect the exchange, financial and capital markets. Financial cooperation should be sustained in order to prevent confusion, while maintaining market flexibility.

Despite the favourable trend toward balance in the world economy, there is still a good possibility that trade friction and protectionism will emerge in the light of existing factors of instability. Particularly, calls for fair trade are mounting in the United States. But, while it is true that trade should be fair, rules on fair trade vary from country to country because of different traditions and trade practices. One-sided attacks and retaliation may result in rampant protectionism under the name of fair trade, and damage the psychological foundation of alliances. Japan should accept international practices and rules and the United States must refrain from taking extreme actions. In this connection, the actual development of the Canada-U.S. Free Trade Agreement deserves attention.

The Free Trade Agreement between Canada and the United States complies with the GATT regulations. Removing trade barriers between the two countries will contribute to the development of their economies and to the overall growth of the world economy. The Agreement will demonstrate the benefits of trade liberalization to other countries and promote the ideal of free trade. In this sense, I think that the trade creation effect of the FTA will be greater than the trade diversion effect.

However, I suspect that this Agreement might have been partly motivated by isolationist feelings of the people of the Western Hemisphere. If this isolationism is allowed to be strengthened, the whole of the world economy will not reap the benefits of free trade. It is particularly important for Canada and the United States to promote trade with fast-growing Asian economies.

Signs are growing that balance in the world economy is being restored. In order to make this a certainty, every nation must make further efforts. Japan must continue to expand its domestic demand and open its markets wider to foreign products. At the same time, advanced nations should hold negotiations on supply and sharing of "international public goods" for the stability and development of the world economy, setting aside the issue of trade friction.

Notes

1. The Report of the Advisory Group on Economic Structural Adjustment for International Harmony (the Maekawa report), April 1986.

2. Ministry of International Trade and Industry 1987 White Paper on International Trade.

Comments

Murray Smith

I was interested in your comments on industrial adjustment in different sectors of the economy and how that might be influenced by the evolution of the balance of payments. For Japan, because of its accumulation of external assets, the economic equivalent to the aging society may be that in the 1990s it will have the size of trade surplus it had in the 1980s. For example, as a matter of accounting, even if Japan had a current account surplus during the 1990s of 3 percent of GNP its merchandise trade would be in substantial balance. If the current account balance were to move toward zero, then the trade structure would involve a deficit, because of the income from overseas investment. That changing composition of the Japanese balance of payments will have very important implications for the structure of Japan industry. How do you anticipate that adjustment will occur in the future?

Yutaka Kosai

As the aging society progresses, it raises the questions of how it will affect Japan's international balance of payments or the savings/investment balance. There is much heated discussion about the effect of the aging society on the savings rate of the economy. The government savings (social security fund) will change to a drain. Whether individual savings can offset this is not so clear. I have a feeling that the savings of elderly people will remain high. Nevertheless, Japanese savings as a whole will dwindle in the future. At the end of the 1980s, Japan will have accumulated a significant amount of foreign assets which will, in turn, offset its domestic savings decline. This will keep Japan's balance of payments on the surplus side for a while because of the interest income earned from these assets.

Although it is very difficult to predict the future, I don't think that international payments will reach a point where they are balanced. The Japanese government estimates that, in 1992, the ratio of current account to the GNP will be less than 2 percent. But, at that time, Japanese national income will be huge and the yen will be strong, so the international balance of payments, in dollar terms, will remain in a surplus position. After 1992 what will be the situation? My general observation is that maybe some time in the future the changes you speak of will take place but, until the 21st century begins, Japanese balance of payments should remain on the surplus side.

As to the necessity of industrial structural change, since the ratio of current account to GNP will reduce, it is clear that industrial restructuring will progress and the nation's import structure will be adjusted by opening domestic markets. But employment can be secured to a certain extent by the expansion of service industries. Furthermore, corporate research, development and marketing will be kept inside Japan and this will help to secure employment.

H.E. English

Could you clarify the kind of structure in the balance of payments you refer to? Nobody expects that Japan will have a balance with individual countries, or a balance on overall trade that corresponds to a balance in the manufacturing or raw material sectors. Clearly, Japan must be an importer of raw materials and an exporter of manufactured goods. I would like to know how you see the trends in the structure of trade, and, in light of the expectation that Japan will be a net exporter of capital, whether it is reasonable that it will continue to have a net surplus on the current account?

I was also recently surprised to discover what a high percentage of Japanese farm income is from non-farm sources. Does this situation provide scope for liberalization of the agricultural sector?

Finally, I was fascinated by Dr. Kishida's comment that individualism is going to creep up on Japan. What do think are the implications for the economy of this trend?

Yutaka Kosai

There is a big uncertainty when we anticipate the future structure of international balance of payments, particularly in the realm of primary products and their prices. I mentioned that there is an increase in the amount of imported manufactured products, but that increase has partly been caused by changes in the price of oil products. Japan's economic structure has been, and will continue to be, greatly affected by changes in the price of raw materials. Suppose that there is relative stability in the price of manufactured products and raw materials. Then, in the 1990s, we can expect that Japan's current account will remain on the surplus side, the overall international balance of payments will be balanced, and the capital account will be on the deficit side, which compensates for the surplus in the current account. To date, the service account has been in deficit but, since the income from investment is turning to a surplus, the invisible trade is close to balance or in a slight surplus.

You mentioned that a major source of rural income is from non-farming sources and that this might facilitate reform. However, instead of acting as an impetus for reform, it is more likely to mean that farmers will stick to small-scale farming because of the existence of double or triple income. Government officials are thinking of liberalizing agriculture and are trying to intensify production. But farmers who have more than one income source can live well with the present arrangement, which is why Japanese agriculture can not become internationally competitive. I do, however, think there will come a time when the aging of the population will reduce the number of farmers in the economy and alter the structure of the agricultural sector.

I would also like to respond to your comment on the impact of individualism on Japan's economic structure. So far, mass production has been the dominant characteristic of Japanese production. People have learned, by repetition, the skills of manufacturing, and cost reduction has relied on this learning experience. But this factor will become weaker in the future. We can no longer rely on worker's skills of mass

production techniques. Research and development must be relied upon, and small-scale, diversified, flexible and liquid industrial structure will be required in the future. So, more so than mass culture, self-centred individualism will be helpful in creating this new type of industrial structure.

Shirley Seward

Canadian governments are beginning to explore new approaches to labour adjustment. For example, the steel industry recently received significant funding from the federal government to develop labour adjustment programs which would involve labour and management working together. I would like to know what Japan has done or is doing in this area.

Yutaka Kosai

My experience in this area, with the Labour Ministry, MITI and a sub-committee dealing with the restructuring of the steel industry, has led me to believe that it is not because of Japanese public policies that the labour market is stable and employment secured. Take the iron and steel industry for example. Although it has been in a condition where adjustment was necessary for quite some time, the industry was hesitant to receive any assistance from the government. The industries took the initiative to diversify themselves by reducing the share of iron and steel content in their business activities, and expanding their other commercial activities. In this process of self-adjustment, they relocated their staff among related and affiliated companies. This is the system of seconding, systematic seconding, or institutionalized seconding. Rather than being assisted by the government, the industry and private companies took the initiative to solve their own problems by reshuffling their personnel among related companies.

Now, from the macroeconomic standpoint, the labour market was adjusted by keeping the economy buoyant. New companies have been created in service and distribution industries in response to the diversification of consumption demand and these companies have created many hundreds of thousands of jobs. Because of this growth of the Japanese economy as a whole, employment or labour adjustments have been successfully carried out.

Japan also has unemployment insurance and social welfare programs and the government has claimed that their public policies and systems have helped in the process of labour market adjustment. But I don't think that Japan's success is attributable to these policies. Corporate initiative, as well as the macroeconomic strengths of the Japanese economy, are clearly the two major factors.

Noriyuki Takayama

It should be pointed out that there is a difference in the definition of unemployment rates between countries. Our definition of unemployment does not include people who are laid off, so our low rate of unemployment is in part due to the way in which we take the statistics.

I would also like to make some other comments in the context of labour market adjustments. In the period of Japan's rapid economic growth, the labour supply to manufacturing and other industries increased very drastically because of the baby-boomers who came into the labour force and because the decline of primary industry freed close to five million workers for other sectors. The baby-boomers and ex-primary industry workers were absorbed into the labour market because of the high economic growth rate of that period. At the same time, however, if you take a look at the employment structure in Japan, one of its characteristics is that Japan has a high percentage of workers in the construction industry compared to other advanced nations. Public investment was enhanced during this period, resulting in an exceptionally high proportion of construction workers in the overall labour force. It was mainly this sector that absorbed the workers who lost jobs in the primary sector and elsewhere. So, the construction sector has played a very important role in Japan.

Schools have also played a role in labour market adjustment. During the period of rapid economic growth, the number of young people attending schools increased very rapidly. At the beginning of this period, the rate of young people entering high school was only 50 percent of the eligible population. However, at the end of the period, the rate increased to 95 percent, and over 40 percent of high school students went on to university. Education has developed very rapidly and a number of potentially unemployed people attended schools, which has kept the unemployment rate relatively low.

In the post-rapid economic growth period, there has been a decline in the labour supply which has coincided with a decline in employment opportunities in many industries. In ship building, in railways, and in iron and steel, people have lost jobs, and the corporations and the government have had to deal with difficult problems pertaining to these unemployed workers. Recently these unemployed workers have begun to migrate into the Tokyo metropolitan area, because the feeling is that, if you are in Tokyo you will always be able to find some work. With a population of 30 million, Tokyo is so big that it offers many ways to earn a living. The deep margin of absorption that a megalopolis like Tokyo possesses has been working rather positively to solve part of the unemployment problem in Japan.

Rod Dobell

Both the labour adjustment questions and processes that we have just heard about, and the financing of investment in very long-term research and development undertakings, are made easier by the large size of Japanese corporations and their corporate families. One of the worries that we have in the Canadian economy with respect to these questions is the simple problem of market power. Our competition policy tends to militate against

associations of very large corporations with the ability to carry out labour market adjustments, diversify within their own enterprise, and sustain the necessary investment in very long-term technological projects over the period when these operations are not recovering their costs. I wonder how the discussion in Japan now stands with respect to this concern about market power and competition policy, and whether it is thought that general economic conditions will make these types of adjustments more difficult in the future.

Yutaka Kosai

First of all, it should be noted that there is no tendency of monopoly in Japan, and, since the second World War, there has been no significant change in the concentration of corporate power. In Japan, you have a great many corporations which are almost the same size. In iron and steel, Nippon Steel is the main corporation, but there are five others that are more or less the same size. In automobiles, Toyota is the largest, but then there is Nissan, Honda and a number of others. In the U.S., the automobile industry is concentrated in the hands of the big three, but in Japan, you have the big seven or eight and they are all very competitive. In the banking sector there are the so called big city banks, and they also compete very fiercely. So, there is no monopolistic or centralization tendency at work.

The relationship between banks and corporations, or the relationship between corporations themselves, is rather tight, and we have a system called corporate groups. Take Toyota for example. It has a great many subcontractors who make parts and components of the automobile. This process leads to a pyramid structure of corporations, with Toyota at the top, and the medium and small companies below that. However, the relationship between the companies is not necessarily hierarchical or patriarchal. There is a significant horizontal relationship and being a subcontractor does not always mean that the company is under the company at the top of the pyramid.

Between the U.S. and Japan, there are certain difficulties pertaining to cartel issues. In Japan, unlike in the U.S., it is legally possible to have a cartel under a recession. Another divergence is the Japanese government's positive attitude towards joint research between different corporations. In the U.S., government control is still very strict and it is difficult to have such a joint corporate effort.

Tom Wilson

In Canada, the small business community is fond of citing figures on the number of new jobs it accounts for. I wonder if, in the Japanese economy, more jobs are also created by small businesses than by the large firms.

Yutaka Kosai

Yes, in Japan this is also the case. The industrial structure is shifting from manufacturing to tertiary industries, which means that the job-creation capacity of smaller enterprises is increasing. Since 1973, the employment capacity of large plants has gradually decreased (although there has recently been a slight recovery of employment by large enterprises), and most new jobs are created by small enterprises.

Thomas Shoyama

One pressing international problem is the resolution of the debt problems of the developing countries. Do you have any comment on what Japan's stake in this issue might be?

Yutaka Kosai

Dr. Saboru Okita's proposal of recycling is one of the leading trains of thought in this area. According to this theory, Japan should make use of international organizations to address the question of developing country debt, which in turn will contribute to a reduction in the U.S. trade deficit. For example, suppose Japan supplies capital to Latin America, and Latin America increases imports from the U.S., then the debt problems of Latin America and the deficit problem of the U.S. can both be addressed.

However, in my personal opinion, I can foresee some problems with the concept of recycling. While the Japanese ability is to lend money, many debtor nations require debt write-offs, or fiscal rather than monetary assistance. I mentioned already that Japan's fiscal situation has improved, but its fiscal budget is still saddled with deficit and Japanese fiscal authorities are hesitant to take this kind of measure. We should not try to solve the problems of debtors nations by merely providing them with loans. Japan should increase its investment and contribution to international public goods.

Atsushi Shimokobe

Japan's greatest debtor is the United States, could you please comment on Japan and the United States in terms of the debt relationship?

Yutaka Kosai

Right now, the East Asian currencies are appreciating and the American continent currencies are falling. So, capital is flowing to the American continent. Japanese credit *vis-à-vis* the U.S. will obviously increase in the future. This is a serious problem and we should address ourselves to it. Through the devaluation of the U.S. dollar, the actual value of loans is decreasing in real terms. A key question is, should Japan continue to

provide monetary cooperation or should it instead contribute to increasing international public goods? By this I mean, Japan can assume the burden of international public goods which used to be on the shoulders of the U.S.A. Our security is not only the security of Japan but also the security of the western free nations. So how to share the burden of international public goods between Japan and the U.S. is the question that we must confront. Unless we consider the cost-sharing of international public goods, the value of the dollar will continue to fall and any credit Japan has with the U.S. will be discounted.

Richard Simeon

The international role of multinational corporations and what their future relationship to governments and states is going to be, strikes me as an important issue. I would like to contrast an American debate and raise a question about Japan with respect to it. It used to be said that what was good for General Motors was good for the country and *vice versa*. There was the feeling that large corporations were in some sense attached to the national interests of their home land. I guess many North Americans would now say that it is no longer the case that the national interest of the United States and that of its major corporations necessarily coincide. Increasingly these corporations have become detached from their national base and are free floating and freely operating entities independent of any loyalty to a particular nation state. Is there this same sense in Japan, and if there is, are there any ways, either informal or formal, in which the activities of Japanese corporations outside of Japan are regulated to ensure compatibility between national and corporate interests?

Yutaka Kosai

I would agree that the role of multinational corporations in global or national economies is an interesting theme. However, I don't think that there is anything like a full fledged, Japanese-based multinational corporation. We have nothing like Shell for example. YKK, the fastener zipper company, which started in Japan, may be one of the typical multinational corporations that we have. Most of the Japanese companies that are internationally active are those that depend on technological expertise, and they are prevalent around the world, but the way in which they work is quite different from the so-called modular model multinational corporations that we see in the west. There are many cases of overseas direct investment by Japanese corporations but it doesn't automatically mean that multinational corporations are increasing in Japan.

The point about the divergence of the corporate interest and the national interest is also quite interesting. Currently Japanese trading companies are paying little tax to the Japanese government because they choose to pay tax at the place where the taxation rate is the lowest.

Social Policy in Changing Japan

Noriyuki Takayama
Hitotsubashi University

In the 40 years since the end of the war, Japanese society has undergone a drastic transformation. This paper will describe aspects of this transformation, discuss the changes that have taken place in the social security system and, finally, outline some themes for future Japanese social policy.

Changes in Japanese Society

The transformation of Japanese society will be described from four perspectives: (1) the realization of an affluent society; (2) the transition to a low growth economy; (3) the aging of society and changes in the status of older people; and (4) changes in the role of women.

The realization of an affluent society

Recently, Japan has become one of the most affluent countries in the world. In 1986, per capita GDP surpassed US $17,000. Today, Japan, which is about to reach a per capita GDP of US $20,000, is ranked along with Switzerland as the world's most affluent country.

In terms of assets, the price of all real estate in Japan at the end of 1986 surpassed 1,300 trillion yen and is 2.5–3 times higher in value than all of the land in the United States. The consolidation of social overhead capital still lags behind, but sooner or later, this problem is expected to be settled.

It is of course, not entirely sufficient to consider only the total sum of the economic indicators. Nevertheless, it is not a mistake to think of Japan as one of the world's most affluent, yet equal, countries (including socialist countries) in terms of its economy.

With the realization of this affluent society, the Japanese lifestyle, and the quality of life pursued, has changed. People are not satisfied with standard lifestyles and individuality is now being demanded. As society becomes affluent, the role played by the public and private sectors needs to be reconsidered.

The transition to a low-growth economy

The Japanese social security system was consolidated during the high-growth period when it was relatively easy to pass on its burden. This is because everyone experienced considerable growth each year in terms of take-home income. However, since the Fall of 1973, the Japanese economy has changed (particularly when it is observed from a yen basis). Since that time, the take-home income of salaried workers entered an era where there has been little growth (e.g., real income increased by only 10 percent in the 10 years between 1975-1985).

Workers are now critical of having money taken out of their pay cheques for social security programs. But, at the same time, social security benefits will continue to grow. Thus, Japan needs to create a system which has the consent of the people who bear the expense of social security.

The aging of society and changes in the status of older people

Japanese are now living longer. At present, one out of two males and two out of three females have a life expectancy of over 80 years. In 1987, the total number of people 65 and over was 11 percent of the total population but, in the 21st century, it will be close to 24 percent. Up to now, Japan was a comparatively young society, but the future will witness a relatively rapid aging of the population.

Previously, Japan's aged population was considered uniformly poor and dependent on welfare. Today, however, the living conditions of the aged are changing. First, a wide dispersion in the lifestyles of the aged has developed. Second, the retired salaried men and their families' pension benefits has become much more substantial (average or median annual amount of the benefits for a man and wife in 1984 was 1,800,000 yen).

Third, although the number of aged privileged persons with income and assets is still small, it is steadily growing. Finally, the number of the aged who enjoy good health is relatively large and many of them are active members of society.

The aged are better off than young or middle-aged persons in terms of possessing assets. Due to the recent sudden rise in the value of real estate, the difference in asset holdings has widened between generations. In the current situation, even if a young person works all his life he will never be able to own a house of his own in Tokyo if he or she is solely dependent on income from labour. Thus, there seems to be a dispersion occurring in the former equity concept centred on income.

During the period of high growth, the aged could be said to be "riding on top of a portable shrine". From now on, they will be required to play a different role in terms of their usage and contribution to the social security system.

Changes in the role of women

The lifestyles of Japanese women have been rapidly changing in recent years because of the low birthrate, reduction of housekeeping work, higher education, and a more independent consciousness. In this environment, the social advancement of women is conspicuous and their employment opportunities have increased rapidly. In 1985, the number of female employees reached about 16 million (70 percent of the female labour force is gainfully employed and 36 percent of all employees are women). The percentage of female employees who are married was close to 60 percent.

As a result of the increase in the number of working women, housekeeping functions have been moved aside and the rearing of children and nursing functions, formerly done by women, are now being taken care of by the social security system.

The Transformation of the Social Security System

The social security system is transforming, along with changes in Japanese society, for example, in the areas of pensions and medical care.

Pensions

The Japanese pension system was formerly divided into three types and eight systems. The walls between the systems were very thick and there was no such thing as transferring revenue resources between them. Furthermore, the benefits formula and

contribution rates differed for each system. The differences between the system caused much concern to the people. (The main objective of the official pension system is to help provide transfer from generation to generation.)

Under a system of separate pensions, it seems inevitable that a group that will not help the older generation will appear. Because the aging of society has progressed much more quickly than expected, there is a rapidly increasing need to review all pensions. There is also rising concern regarding incentive compatibility and the growing burden placed on the national treasury by the pension system.

The 1986 revision of the pension system changed the basic direction of pensions. Instead of increasing the benefits, the trend is now toward holding down their level and the simultaneous consideration of benefits and burdens. The basic pension benefits of the system are connected by a thread that runs crosswise and the walls between the systems, on the fixed amount portion, have been completely removed. Proportional pension benefits are now based on the same formula among different payment plans. For the funding, there are differences left in each system, but the movement towards a unification of the system has been started.

Medical care

Medical demands are changing drastically. The emphasis on contagious diseases has decreased and now the focus is on chronic old age illnesses. The relative importance of externality in medical care has also declined, while interest in amenities and informed consent is increasing. At the same time, the basis of medical care is expanding to include preventative health care and terminal care.

Medical insurance is undergoing drastic change as the population ages. In particular, "the living costs" that accompany the hospitalization of the aged are increasing unchecked. Even if these patients can be treated at home or as out-patients they often continue to remain in the hospital. The weight of the medical treatment in these cases is relatively small. Living costs are seen as a hospital expense and are paid by medical insurance and not by pensions.

National medical care expenses are increasing at a rate of about one trillion yen per year. The majority of that expense is not related to primary medical care but to the "living portion" of the elderly in-patients. If the current policy of holding down medical care expense is continued for a long time, the system may be crushed by these living expenses. As a result, there is a fear that the promotion of technical advancement or quality improvement of medical care, as well as the development of new medicine, will be hampered.

Those 65 years and over comprise 11 percent of the total population, but are using one-third of the total medical care expenses. This is the present situation. But sooner or later medical care expenses for the elderly will reach over half of all expenses.

Themes for Future Social Policy

What themes for the future does the present social policy system, centred on pensions and medical care, present? This section looks at three: the role of the public and the private sectors; the integration of social policy; and the role of the elderly.

Reconsidering the role of public and private

Formerly, people viewed the range of pensions and medical care as the responsibility of the government. However, this line of thinking is being revised.

Even though we say that Japan has 100 million people in the middle class, there are within that middle class upper and lower ranks. As the official pension can only be the greatest common denominator, its benefits must be aimed at covering the living costs of the "lower middle class". Those who are seeking "middle of the middle class" or "upper middle class" status will have to strive for private pensions through their job or on an individual basis. Accordingly, it is desirable that further assistance from the taxation system be given to private pensions.

The burden of the pension system shouldered by the private sector has to be increased gradually but this should be done in such a way that the living balance between generations is not destroyed. It is believed that various reforms will be planned to find one that will maintain a stable living balance. It is important to maintain the balance of contributions and benefits. Even so, the problem of unification of employee's pension systems (especially that of contribution rates) cannot be avoided.

In terms of medical care, a different structure will be considered by separating the living expense portion from the main medical care. It might also be possible to hold down terminal medical care expenses within the social insurance system. Furthermore, there is a possibility that medicine expenses can be funded by establishing a different payment rate from the other medical care payments.

Regarding welfare service, it is believed that a nationwide standard service is not desirable. Instead, the local governments should implement policies that will strengthen community services according to the needs of the residents. The private sector should play a major role in promoting quality service that is responsive to the needs of the people receiving the service.

In other words, the roles played by private and public sectors should not be exclusive. Rather, plans need to be made where there is mutual cooperation.

The integration of social policy

In the past, social policy was conceived within a vertically divided system. Thus, separate policies were made with little regard for mutual linking or integration. However, pension benefits have already reached a considerable level and there is the problem of pension beneficiaries who, through being hospitalized for a long time or utilizing special nursing homes, are the double recipients of living expenses from pensions and medical care or welfare.

Since living expenses of the elderly are guaranteed by pensions, it is hoped that medical care and welfare related to the living costs of the elderly will be disbursed through pensions. In other words, there should be an integrated social policy that considers pensions and the various services of health, medical care, welfare, and employment.

The participation and obligation of the elderly

There are many phases in social policy in terms of the redistribution of income between generations. As the society ages, it is very important not to destroy the living balance between the active generation and the retired generation. Up to now, the elderly have been "carried" by younger people. This, however, cannot be continued. In the future, aged persons cannot just be recipients of social services. They will also have to start contributing to social services as expense-sharers. As mentioned, many elderly are blessed with considerable assets and there is a need to increase income flows from real assets through one or more channels.

In the case of pensions, consideration will be on combatting the rising percentage of contribution by the national treasury to basic pensions by supplementing the tax source. Aged persons will be required to contribute within their means. Without doubt, there will be attempts to raise the retirement age, to reconsider the benefits indexation indicators, and to hold down excessive benefits.

In the revision of medical care, one can expect that the sources of transfer from general revenue (e.g., how to balance taxing income, consumption and assets) will be reviewed again. Hereafter, it will be also necessary to study plans regarding the contribution made by pension recipients toward medical insurance. Increasing efficiency of the supply side of medical care must also be pursued. An incentive system needs to be developed in order to promote medical care service and further promote health.

Comments

Shirley Seward

In Canada there has been a significant increase in the labour force participation of women from 52 percent in 1981 to almost 56 percent in 1986. Furthermore, the participation rate is particularly high for married women of child-bearing age. This is placing great pressure on a number of social programs. For example, there has been pressure for more adequate child care and more employment equity programs. Have there been similar changes in the role of Japanese women in the labour force? Are there major differences in occupational structure with respect to women and men? What are the wage differentials between men and women? (In Canada women earn, on average, only two-thirds of what men earn.) Has there been pressure to provide child care for those women who are in the labour force to give them more flexibility to handle all their responsibilities?

I was also interested in your comments about single elderly women and wondered if there have been initiatives to provide more adequate pensions for these women?

Noriyuki Takayama

As a tendency, the proportion of women in the labour force has been increasing. However, the structure of the female workforce is complex and their interests are not necessarily unified. Professional women are increasing in number, but the great majority of working women quit their jobs when they marry and, after a time, go back to the labour market, especially as part-time workers. In a sense, women's participation in the labour force is dichotomized. On the one hand, we have a group of women who are competing fairly well with men, and although they are still a minority in numbers, their segment of the workforce is increasing. On the other hand, we have the great majority of women workers who are primarily part-time employees, and their numbers are also increasing. Sometimes the interests of these two groups collide.

There is a wage differential between men and women, but it is partly explained by the fact that the majority of female workers are employed part-time, and is not purely a matter of sex differentiation. The average wage level of women is 60 percent of the salary of men, as a whole.

The widow's pension was increased drastically in 1986. Formerly, while both spouses were alive, they received a pension as a couple but, when the husband died, the women would receive only half of the pension. However, this has now been increased to three-quarters of the original pension.

Child day-care centres can be seen almost everywhere in Japan and in general there have been sufficient facilities. The one exception would be for very young babies or newborns, whom very few centres will accept.

It should be noted that, whatever the demand for a social policy, whether it be child day-care or medical insurance, once the Japanese government concludes that it is an important issue it will be fully committed and responsible for the provision of the service.

Richard Simeon

It has been suggested that the Japanese are not very good at anticipating and debating social policy issues. Would you comment on the political process where this type of debate takes place and where the initiatives are taken. Is it a bureaucratically centred process? Similarly, what is the role of the LDP, trade unions, corporations and other interest groups in these debates, and has there been the emergence of new effective interest groups representing the interests of women and older people, etc.?

In Canada we have had a lot of debate recently about whether the social policy system creates barriers to economic adjustment and the need to more effectively link social and economic policy. Has there been that kind of debate in Japan?

Noriyuki Takayama

Japanese interest groups do engage in this type of debate and once their opinions are made explicit they are respected to a great extent. In other words, the political adjustment process does not drastically restrict the interests of a particular group. The impact of aged people as an interest group is clearly going to increase. As an illustration, people who are already receiving pension benefits will not be affected at all by the 1986 pension reforms.

As for the implications of social programs on the overall economy of Japan, the ratio of social security benefit expenditures to national income was 14 percent in 1985, which is quite significant and increasing rapidly. Corporate equipment investment, employment plans and private savings plans will clearly be effected by this ratio.

Thomas Wilson

Am I correct in assuming that your pensions are what we would describe as a pay-as-you-go system, as opposed to a funded system? Also, it seems that there will be a sharp increase in the burden on the young to pay for the expanded pensions of the elderly. Has there been any consideration of alternative ways to fund the pension system within the tax system, for example, shifting some of the burden to property income, from employment income, or using indirect taxes instead of payroll taxes to try and spread the burden more evenly?

Noriyuki Takayama

Japan's pension system still has a fairly high level of reserve so, on the surface, it looks as if it were a funded and contributory one. However, this funded element can only explain 10 percent to 20 percent of the pension benefits actually paid. You are right in assuming that our pension is a pay-as-you-go system.

The government contribution from general revenue can be described in the following way: The flat rate benefit per month, per person, is 50,000 yen, one-third of which will be covered by the national treasury and the remainder coming from the contributions of individuals. Yet as the number of aged people increases, individual contributions will have to be raised so much that a number of people will have difficulty paying. So the transfer from general revenue will have to be increased more, maybe through consumer tax measures.

Of course, our system still has a relatively short history and the problems we are now encountering are those at the start-up phase. We will manage to find better solutions as we proceed.

H.E. English

OECD figures purport to demonstrate that Japan's income distribution is one of the most equal of the OECD countries. I would like to know whether you think these figures are an accurate reality of the Japanese situation.

Noriyuki Takayama

As Japanese statistics are well-organized and credible we can say that the OECD statistics are accurate. Japan's rapid economic growth started in 1960 and continued until 1973. During this period, the starting salaries of new employees grew very rapidly. In the past, there was a one-to-five gap between the starting salary and the retiring salary. Now, the ratio is only one-to-two and one-half, or three. Among the free economy countries this represents a fairly equal distribution of income. In addition, Japan's income tax has a very clear progressive rate.

This equalization of wage income in Japan proceeded until 1975 when the Gini coefficient was approximately 0.2. However, since then the wage gap has become slightly larger. Some people feel that there is too much equality in income distribution and this reduces labour's incentive to work. Accordingly, there is a growing mood to acknowledge an appropriate gap in income as an incentive for efficient work.

Atsushi Shimokobe

I would like to add some comments about a unique feature of Japanese society. Within the aged population group, there is an increasing discrepancy in income distribution.

Those who have property and stocks, thanks to the increase in the price of those assets, have become very rich aged people and are trying to rapidly transfer their assets to the younger people. Many young people rely on their rich aged relatives to help them get married, buy a house, or educate their children. They are living on the transferred properties of the aged. So this increasing burden on the young mentioned in the discussion of the pension system is only one side of the story.

Warning on Techno-Nationalism: From Economic Friction to Technological Friction

Toru Yano
Kyoto University

A New Area of U.S.-Japan Friction

Since the latter part of 1987, there has been a new kind of friction in U.S.-Japan diplomatic relations—scientific technology friction. This friction is, in part, the result of problems which arose over the extension of the U.S.-Japan Scientific Technology Research and Development Cooperation Agreement in April 1987. Problems which had been smoldering at the private level moved to the government level. The friction was probably initiated by the Fujitsu Co. Ltd.'s proposed takeover of the American firm, Fairchild Semiconductor, in the fall of 1986 and the Toshiba COCOM incident. Although President Reagan did not intervene officially during the Fujitsu incident, he was, by that time, openly favouring a more interventionist policy on science and technology issues.

The rationale for this interventionist policy can be found in the underlying philosophy of the Reagan administration which has continuously sought a "stronger America". In his State of the Union Message in January 1987, Reagan aroused worldwide interest by announcing six approaches to strengthening U.S. international competitiveness. Three of the approaches are:

"increased investment in human and intellectual resources";

"enforced protection of intellectual rights"; and

"fostering scientific and technical development."

(The fact that enforced protection of intellectual rights was already a goal at that time should be noted.)

There seemed to be an almost fanatical desire on the part of the Reagan Administration to regain American global pre-eminence. The U.S., which has started to lose its dominance in the area of technical development, will increasingly have to depend on the technology of other western countries for its security. The U.S. must worry about becoming technologically inferior in critical areas such as micro-electronics. With this concern, the Reagan Administration, in its final months, faced a crisis which may be more serious than the "twin deficits". Since this crisis revolves around science and technology which, in some sense, can be considered the nucleus of contemporary civilization itself, it has become a psychological problem for many countries. Accordingly, there is now a growing understanding of the need to establish a new set of "game rules".

Given the declining status of the U.S., and Japan's rapid transformation into a technologically advanced nation, it is not surprising that Japan has become the scapegoat for the current diplomatic friction, triggered by the revision of the Scientific Technology Agreement. The U.S. made its views and demands clear to Japan in a series of diplomatic negotiations and at the November 1987 "Conference on Advanced Technology and International Environment Related to the U.S. and Japan".

The point that the U.S. has repeatedly stressed in its complaints is that there is an imbalance between the U.S. and Japan in the acceptance of research scientists and free access to scientific and technological information. Flowing from this viewpoint, is the U.S. demand for symmetrical or equal access.

In addition, the demand for protection of intellectual rights in President Reagan's State of the Union Message seems to impose secrecy obligations and other such constraints, which affect all aspects of scientific technological research. The idea that inventions and discoveries are the possession of the researcher or the country of origin, has dominated recent diplomatic negotiations. The raising of this so-called territorial principle in such discussions is both truly unexpected and regrettable. The Japanese government has consistently rejected this idea of possession of intellectual property, although there seems to be a weakness or indecisiveness on its part when it comes to a diplomatic settlement of this issue.

The important fact, however, is that at present there is too much friction between the U.S. and Japan. The Scientific and Technological Agreement was extended until the end of April 1987, further extended by three months at the end of October 1987, and modified at the end of January 1988, with another two month extension. During these discussions, one could see a stark contrast between the positions of the U.S. and Japan. Japan's Ministry of Foreign Affairs has taken a broad view of the U.S.-Japan relationship and projected a positive attitude toward the resolution of this situation. On the other hand, the forcefulness of the U.S. demands seems to indicate a new form of "Japan-bashing".

However, the attitude of Japan towards the U.S. throughout these developments has not always been clear. Japanese say they lack confidence in Japan's capabilities in the areas of science and technology. In a sense, this is a basic cultural weakness. Moreover, as scientific and technological problems have become a diplomatic issue, Japan has suffered from not having a reasoned position based on a coherent philosophy that can

be presented with confidence to other countries. The words of the diplomats who conduct the negotiation are their own, that is, they have not been formed by the ideals and philosophy of Japanese scientists or technicians. Japan has not advanced to the level where these opinions are conveyed to, and guide, the parties conducting the diplomatic negotiations.

The Ministry of Foreign Affairs itself has a problem. The mechanism to deal with scientific and technological problems is weak and cannot meet the actual demands placed on it. While the Economic Affairs Bureau or the Economic Cooperation Bureau handle economic issues, scientific and technological problems fall under the jurisdiction of the United Nations Bureau. (Fortunately, the Science and Technology Agency's international department handles the same problem from its own standpoint, and the Science and Technical Council also gives advice.)

It is time that the Ministry of Foreign Affairs reconsider its long-term approach to the problems of science and technology and how these problems fit with other diplomatic goals. Japan has not fully developed a position on the relationship of science and technology problems to the process of the country's "internationalization" which has become in itself a national debate.

At least two new important sources of U.S.-Japan friction have emerged in the last few months. One is nationalism and the other is the emphasis on the relationship between knowledge and national interests. Ironically, until recently, the U.S. has been regarded as the most supportive country in the search for a global perspective on science and technical issues.

An objective observer would have to conclude that the situation is quite dangerous. On the one hand, it is natural that the U.S. position be challenged. However, if, because of this, Japan moves toward greater nationalism and competes for world dominance with the U.S., the existing world scientific and technological order could collapse. Therefore, the diplomatic attitude Japan takes must be calculated and rational and should contribute to the establishment of a new international order.

Clearly, Japan should take a hard look at the criticisms being leveled at it, and, taking those criticisms into consideration, move to create an international stance that is in keeping with its position as a major technological nation. Until recently, Japan's economy was dominated by mature industries such as steel, in which there was little room for technical revolution and, because of this, Japan was considered a developing country. But, Japan is no longer a developing nation. It is constantly striving to develop more advanced science and technology which will permit it unlimited development. What is imperative now is to create the necessary conditions for such an advancement.

Within the larger argument on "internationalization", there is a need to define the science and technology problem. By doing so, Japan will not only create an effective international orientation for itself, but will also learn how to construct a global scientific and technological order.

The "Scientific and Technology Policy General Rules", which were decided by the Cabinet in March 1965, have provided a rough logic for the formulation of Japan's policy

in this area. Although it is only an eight-page document, it has systematically spelled out a basic course to follow and, as such, is a rare document on the international scene. It is, however, only a general policy statement and the ideas should be put into a more concrete form. (Outside pressure will probably help to accomplish this.)

Japan must develop a clear philosophy regarding the type of world order of science and technology it seeks and how this will relate to the unique cultural framework it is now trying to construct. Until it does so, the negotiations with the U.S. are unlikely to make significant progress.

The Folly of the American Position

The friction over science and technology has exposed a narrow, short-sighted side of American policy. The U.S. is clearly retreating from a position of globalism to one of nationalism and, for doing so, is rightfully the target of much international criticism.

For instance, a recent article in the noted magazine *Neicha* (Nature)[1] criticized the U.S. attitude and called the bogged-down negotiations over a new basic research agreement between the governments of Japan and the U.S. an "unnecessary dispute". It laid most of the blame for the problems in the negotiations on the behavior of the United States, suggesting that it was making unrealistic demands and was essentially bullying Japan. The article offers the opinion that the philosophy supporting the United States' position is that basic research includes the value of the technology that comes out of the research, and is a critical structural part of economic power.

It is customary to describe this attitude as "techno-nationalism". Techno-nationalists maintain that the practical benefits created through science and technology should be confined primarily to the country of origin. This type of nationalism is peculiar to advanced nations and reflects an outdated, isolationist mentality. Regrettably, when science and technology become tied to nationalistic motives, it takes on an amoral connotation.

There is clear evidence that at present the government and people of the U.S. have been captured by techno-nationalism. At least four dimensions, or expressions of it, can be identified. First, techno-nationalism appears to have been adopted as the national strategy to ride out the short transition period between the 1980s and the 1990s. (The U.S. has not fallen to such a low point as to use techno-nationalism as a long-term strategy.) Second, in spite of the above, it has been incorporated into public policy and has reached the stage where it will be legalized in various ways. Third, techno-nationalism is not only a government policy but also has widespread support amongst the public and certain sectors of academia. Fourth, Japan has been the primary target of this movement.

Science and technology should have universal characteristics and be seen as international public goods. Techno-nationalism runs counter to techno-globalism, which is now, without doubt, the international reality. Information about scientific discoveries

becomes global public goods by virtue of the close and free interchange between scholars and the rapid development of communications. Furthermore, the interests of private enterprises and the state are gradually moving apart, and firms are losing their national identity. This process suggests another powerful reason why techno-nationalism is not a viable position.

The attitude the U.S. has adopted toward the world on these issues, has been engendered by a number of inherent domestic problems. First, while compared to Japan the U.S. is a country with superb creativity, there is a large gap in the U.S. between scientific discovery and application. As Robert B. Rhine states, "Americans will continue to lead the world in scientific discoveries and Nobel prizes, but find it difficult to commercialize the basic inventions. They seem to become stuck between invention and applications. In contrast, in Japan, the starting point is a major discovery and people have a superior ability to develop applications."[2] If this viewpoint is adopted, a country must stop thinking about discovery from a purely scholastic standpoint for, no matter how many Nobel prizes the scholars of that country win, discovery without application is meaningless.

Second, and related to the previous point, U.S. science and technology policy is too deeply involved with national defense considerations. The U.S. budget for research and development is excessively dependent on the Pentagon. Furthermore, American academic circles do not adequately question whether this is right or wrong. This connection between science and technology and national defense became much stronger under the Reagan Administration. At the same time, abuses of this connection, such as the delay in transferring to the commercial sector technology or materials developed for military purposes (which has been called the "backlogging of technology phenomena"), and the funneling of superior talent into the war industry, have also escalated.

Another critical problem is the hollowing of U.S. industry. The decline of the industrial complex in the United States is progressing so quickly that it cannot increase profits through the commercialization of present knowledge. It is estimated that over 40 percent of the advanced electronics products used by U.S. ordnance systems are imported from Japan. Similarly, U.S. dependency on external markets for the supply of ceramic packages to mount chip circuits is very high.

Success in such advanced fields as microelectronics, in which generational changes have great impact, is largely a consequence of research and development expenditures. U.S. companies that can compete with Japanese companies, which have good cost management, are becoming increasingly scarce. In short, a scientific and technological civilization is supported not only by the theory from purely scholastic fields but, perhaps even more importantly, by the capacity of the entire society.

The fourth problem the U.S. faces is the ethnocentrism of its scientific and technological community, which has recently become worse. Scientists in the U.S. are extremely indifferent to the research efforts of other countries. There is a notable and lamentable tendency to ignore overseas information. U.S. scientists are being poisoned by a "one language syndrome", thinking that English is the only international language. The will to learn another language to obtain necessary information has declined rapidly.

U.S. scientists are also very uncritical of the push towards nationalization of learning. Willingly entrusting themselves to furthering the interests of the country, has become part of the U.S. academic culture.

These problems have formed the basis of the U.S. attitude against Japan. On the other hand, these influences are largely absent in Japan, which makes it difficult for it to deal with the U.S. demands. If the problems and characteristics of each country are boiled down, one can observe that there are a great many differences, which leads to the conclusion that perhaps the current friction centering on science and technology is in some sense a friction of civilizations. Furthermore, it will be more difficult to revive the spirit of "techno-globalism" and to successfully manage the diplomatic negotiations because the will to convince the American public of its necessity seems to be lacking in the present U.S. administration.

Many Americans point out that there is a strange psychology among Americans scientists which can be called the "transistor complex". The transistor was discovered in 1947 at Bell Laboratory. Because of the outstanding scientific and technological level of the U.S. at that time, and the belief that this discovery should be made the public property of the world, America openly acknowledged its global application. There is now, however, an historical reflection that this decision has not helped build a strong U.S. economy.

At present, there are indications in the U.S. of the so-called "pathology of a declining civilization". But before rushing to the conclusion that the U.S. is bound for obscurity, it is essential to examine whether the techno-nationalism which the U.S. now holds aloft is a short-term phenomenon or a long-term one. I personally see it as a short-term phenomenon but, if it develops into a long-term strategy, it can be taken as a sign that the U.S. ship is sinking.

The Age of Technical Diplomacy

What lessons should Japan derive from the escalating technical friction between the U.S. and Japan? Clearly, it is critical to objectively analyze Japan's international position and its advantages and disadvantages. But, perhaps more important, is the notion that Japan must not adopt the techno-nationalism that prevails in other advanced countries.

It should not be overlooked that U.S.-Japan technical friction is basically a diplomatic problem and not a problem of science itself. However, the suggestion that we address this problem by improving our science and technology policy is inadequate. We must, at the same time, develop new diplomatic concepts and strategies.

The transition from a diplomacy based on traditional economic perspectives, to one based on technical considerations will result in Japan's interests being tested in new and different ways. It will, therefore, be important to consider which problems scientific and technical specialists can deal with and which will have to be dealt with by diplomats.

A superficial look at the coming age of technical diplomacy could lead to the feeling that Japan will possess an international advantage. But, that would be a wrong position to adopt for several important reasons. First, the relationship between technical diplomacy and the international system needs to be scrutinized. Economic diplomacy can be practiced as long as it adapts to the international economic order, free market principles, and to the internationally accepted principles established by GATT and the IMF system. Economic friction between two countries is basically friction over trade share, which in principle is a matter which can be settled by compromise. In contrast, if technical diplomacy were to develop further along Japanese lines, some very basic questions will be raised as to how Japan can construct a world order governing technology and science. The present international system is supported by the mutual checks and balances of the U.S. and U.S.S.R., and the philosophy and ideas of Japanese technical diplomacy may be at odds with the existing system. If Japan directs its attention toward converting the present international system, its technical diplomacy could become a cause of international tension.

Second, the present international situation is very delicate. In the autumn 1987 summit meeting between the U.S. and U.S.S.R., it was agreed to eliminate the INF (intermediate range nuclear force) entirely. Some say we are now entering a new age of detente and in that age the strategic mutual check between the U.S. and the U.S.S.R. will become much more sensitive. Tension over matters involving military technology, or civilian technology which can be converted to military use, will increase. Technical diplomacy in this situation will be founded on the strictest surveillance conditions by both the U.S. and the U.S.S.R.

Any agreement on nuclear disarmament will inevitably lead to an agreement on the balance of conventional forces. Recently, the military capabilities of conventional forces have risen significantly as a result of technical developments. Consequently, any action by Japan in this area is a matter of worldwide concern. With the U.S. and the U.S.S.R. moving toward detente, there is a tendency for the development of "enclosure" competition for military technology. Accordingly, it will become more difficult for Japan to conduct technical diplomacy.

The third reason why Japan's technical diplomacy will face problems is that peaceful technical diplomacy itself will be a cause of economic friction. If most of the technological or scientific know-how existing today were not commercialized, it would not be in existence. This is accepted common sense. Therefore, the active development of technical diplomacy and further technical development in non-military areas will, in the eyes of many foreign countries, be seen as an economic intrusion by Japan.

Seymour Melman has written that the more an advanced country spends on defense, the faster its economic growth level, as measured by productivity, declines.[3] A country is obviously an extremely complex management system and any overemphasis on one sector of the economy, such as the military, is decidedly uneconomical. For both the U.S. and the U.S.S.R., sound economic management demands a reduction of the military budget. The tragedy is, that although the two military superpowers are aware that their existing economic management programs are damaging, they can do little about it. They are essentially tied together by their own ropes. The free technical diplomacy of Japan is

seen as direct economic diplomacy, which will introduce a chain reaction and a need for economic retaliation.

The fourth problem is that when it comes to the age of technical diplomacy, the voices of scientists or technicians will become relatively more important and there is a possibility that their judgements and viewpoints on matters may disrupt diplomacy. It is natural for scientists and technicians to be indifferent toward delicate diplomatic matters concerning international political affairs. They generally hold the opinion that scientific discoveries are the common property of mankind. Although this is a valid and sensible opinion, in the world of diplomacy it is not always feasible.

The age of technical diplomacy will continue to increase the importance of the opinions of those in the industrial field. This is especially true in Japan, where the proportion of private laboratories to public or university laboratories is high. Technical diplomacy cannot progress without adequately reflecting the voice of private industry. However, there is no guarantee that private industry will accept the need for diplomatic finesse. Likewise, there is no guarantee that the persons involved with private industry can conduct good, well-formed arguments on science and technology.

The fifth problem is that Japan's technical diplomacy is inseparably linked with U.S.-Japan relationship. The U.S. is trying to settle the science and technology problem through bilateral diplomatic channels. It will likely be very critical if Japan tries to pursue a multilateral-type of technical diplomatic policy separately from the U.S.-Japan relationship. Furthermore, as shown by the friction revolving around the revision of the Scientific Technical Agreement, Japan cannot seem to formulate a scientific and technological policy which can be accepted or even understood by the U.S., which is clearly a very serious obstacle.

The sixth difficulty confronting Japan in its pursuit of technical diplomacy is that the position of the Third World will become more and more problematic. In the past economic and technical cooperation with the Third World has been handled relatively well within the framework of economic diplomacy. However, it will become more and more difficult to construct a worldwide framework for technical diplomacy that will effectively accommodate the changing and increasing demands of the Third World. With the technological gap between the developed and developing nations widening, the difference in the emphasis of diplomacy becomes much more conspicuous, which exacerbates the difficulties. The key issue is what is the most appropriate technical diplomacy to deal with the Third World and how does it differ from the conventional economic diplomacy.

The seventh and final problem relates to the future situation of Japan in Asia. If the world is moving towards an age of technical diplomacy, the role of East Asia in international relations will become prominent. In addition to Japan, Korea, Taiwan and Singapore are also likely to set forth on their own path of technical diplomacy. There is the potential that the actions of these countries will disturb the international order. If that does come to pass, the rest of the world is likely to blame Japan for not being able to establish sound "game rules" in East Asia.

Japan might also be subject to another kind of friction in its relationship with various East Asian countries. The Asian NICs may take advantage of the technical diplomacy developed by Japan toward advanced countries such as the U.S., and use it against Japan. It is yet unclear whether Japan can persuade its neighbors to put together a coordinated technical diplomacy that will not harm Japan, even when applied against it.

Diplomacy on technological issues will require uniquely complex diplomatic considerations which are beyond the normal thinking of most scientists or technicians. It will be necessary for Japanese scientists and technicians to learn more about various diplomatic problems, just as it will be necessary for diplomats to try to learn more about the knowledge possessed by scientists and technicians in their respective fields, if they are to understand the development of technological issues in diplomacy and develop an appropriate strategy. Japan's diplomacy remains focused on economics. This focus will become dangerous as time goes by and needs to incorporate new concepts which are suitable for the age of technology which is just around the corner.

Japan's Capability in Science and Technology

Although there is no reason for Japan to feel inferior in terms of its science and technology, it is not yet at the same level as the United States. This can be seen in the comparison of the number of Nobel prizes won by scientists of the two countries. While Japan has won only five Nobel prizes in the natural sciences, the United States has won 142. This lack of Nobel prize winners is one reason why Europe and the United States view Japan as a developing country in terms of science and technology.

Many people believe that Japan's modernization has been accomplished almost entirely by copying the advanced technology of others. Japan's development, then, is perceived to be based on "mimicry" rather than originality or creativity. This perception is particularly evident in Europe and America, where the view that the "essence" of science and technology is inventions and discoveries, is prevalent.

The current view of Japan in this most recent round of friction between the two countries is characterized by strong contradictions. On the one hand, the United States asserts that Japan is getting a free ride on United States' research, an assertion that implies that Japan is still in the process of catching up. On the other hand, it has also expressed unease about Japan's advanced technical level.

The view of Japan as an innovative country was expressed succinctly in a recent New York Times article. The article asserted that in the last 10 years Japan has produced more advanced technical innovation than the U.S., making it, in contrast to its stereotypical image, an advanced country in science and technology.[4]

This change in perception corresponds to the changing concept of what is involved in scientific research. In the 19th century, the image of scientific research was one in

which scientists valued originality above all else. However, the view of science is changing rapidly to incorporate diffusion as well as innovation and one can effectively make the case for imitation as one type of innovation. The extension of this argument is that making perfect copies, as Japan is accused of doing, is very difficult to do, and that by this measurement Japan is an innovative country.

Modern innovation is done by effectively combining applied scientific technology and commercialization. In other words, it is the "socialization" of science and technology. Conversely, scientific knowledge, no matter how it has been gained, will never contribute to the capabilities of that country if it cannot be "socialized". Accordingly, understanding and appreciation of scientific technology should go beyond pure knowledge and technical formulae, and consider aspects of economics, industry, the financial markets, and effects on the daily life of people. Thus, its value should not be judged solely on originality, as is the case with the awarding of Nobel prizes. It should also be judged by its commercialization or applied value, or by how it relates to, and sheds light on, human or non-scientific values. If scientific and technological knowledge can be considered as a social "stock", it is as important to devise a way to distribute the "stock" as it is to increase it.

It is in this area where Japanese scientific techniques have progressed further than those of the United States. The state of U.S.-Japan relations today is similar to relations between the United States and Great Britain in the early part of the 20th century, when England possessed the basic know-how, but was not able to apply it and was eventually left behind by the U.S., which was.

A good example of this is the development of the radar. The principles of radar were discovered in Britain, but Britain had to leave its development and application to the United States. Thus, despite the fact that it did not invent radar, the United States became the most advanced country in radar technology. One can learn much about the current U.S.-Japan dispute from studying the process by which the United States surpassed the more scientifically advanced Britain. Japan is about to stand in the position formerly occupied by the United States. (It is already dominant in the field of VLSI chips, high-precision machinery and optical electronics.)

This situation presents a very delicate diplomatic problem. If the United States were far superior to Japan in terms of science and technology, these sorts of diplomatic problems would not occur. Nor would they occur if the extent of the effects of science and technology were limited to the laboratory. But today, the application and socialization of science and technology is an important issue and therefore gets involved with diplomacy. Also, the fact that current U.S.-Japan relations are similar to those which previously existed between Britain and the U.S. is a touchy psychological issue.

Japan must view the problems of science and technology from a broad perspective. The effects of scientific technology extend well beyond the academic field; the economy, industry, national defense and the whole of society are also affected. There should be constant exchanges of opinions between academic circles, on the one hand, and govern-

ment and industry, on the other. It would also be desirable to hear the opinions of sociologists.

It is especially important to strike an appropriate balance between the main pillars of science and technology—invention, innovation and diffusion. In Japan's case, it will mean working on developing the theory demanded for development and modernization. Unless Japan develops a sound theoretical framework, its reputation as a serious science and technology power will be constantly in question.

Japan should develop a firm position on techno-globalism and take action that accurately reflects this position. It should strongly oppose techno-nationalism, even if this action temporarily aggravates its relations with the United States, because such an action will be evaluated favorably by other countries. In other words, Japan should consider science and technology issues from a broad perspective, rather than just as a bilateral problem between Japan and the United States.

The contents of this techno-globalism, however, are a problem. In the long-term, this concept will surely progress as one element of a "world science and technology order". But while scientists and technicians talk with relative ease about such an order, in reality its achievement will be a very difficult diplomatic task. Japan's contribution to science and technology in Third World development will also be a major issue.

In order for Japan to become a Mecca for science and technology, the efforts of both the government and the people will be needed. The current U.S. demand for equal access has some basis of truth. For example, compared to the number of Japanese studying or conducting research in the United States, the number of American researchers in Japan is small. It is also true that while there have been Japanese who have won Nobel prizes as a result of studying in foreign research institutes, there is no foreigner who has received a Nobel prize as a result of doing research in Japan. In the eyes of the world, Japan is far from being a centre for scientific and technological research.

There are many areas of research, such as computers, bio-science, and superconductors, that are still underdeveloped and Japan must establish a generously funded system for advanced research in these areas. This effort should include laboratory facilities and research institutes with specialists from many different fields. In addition, there is an urgent need to strengthen the existing capabilities of university research. The closed nature of Japan's national and state universities is detrimental to the development of science and technology. Given the fact that private research laboratories can hardly be called open, one can say that this is a pervasive problem in the entire Japanese research system.

The final point is that the diplomatic functions of government, particularly those of the Ministry of Foreign Affairs, must be consolidated to prepare for the changing emphasis from economic to technical issues. It is unwise to leave science and technology issues in the hands of the United Nations Bureau of the Ministry of Foreign Affairs.

The government needs to take a greater role in promoting science and technology. Japan started, under the previous Nakasone administration, to make proposals and positive statements to the rest of the world regarding Japan's policy in this area. There

was great interest, for instance, in Japan's announcement of a program for "Human Frontier Science" during the 1987 Venice Summit (and confirmed during the 1988 Toronto Summit).

This is the sort of orientation that Japan should take. The government is expected to promote the large-scale development of science and technology. But, in order for the government to play an effective role, there needs to be an effective linking between industry and government. As Japan becomes internationally prominent in science and technology, the role of government in initiating activities in research and development will become more and more important.

The future of science and technology is limitless and Japan will play a larger and larger role in attempts to bring science and technology under international rules. The Japanese, who are not used to being led by a sense of the future, must now proceed in that direction, because the current friction between the United States and Japan on technical issues is just the first skirmish in this coming battle.

Notes

1. *Neicha*, Volume 331, February 4, 1988.
2. Robert B. Rhine, "The danger of techno-nationalism coming into the limelight", *Seiron*, December, 1987.
3. See Seymour Melman, *Pentagon Capitalism* (New York: McGraw-Hill, 1970).
4. "Novel technique shows Japanese outpace americans in innovation", *New York Times*, March 7, 1988, I, 1:3.

Comments

Rod Dobell

Your argument that technical knowledge is the common property of all humanity solves the problems of general access to knowledge, but does not address the issues of adequate pace of technological development or incentives for investment in research and development. You have also rejected the U.S. view that there can be national possession of intellectual property and suggest that a peaceful technical diplomacy might start from a regional basis. Could you help me understand the nature of that middle path and how we might reconcile the demand for equal access to knowledge and the need to create incentives for the development of new knowledge?

Toru Yano

For more than a year, U.S.-Japan negotiations on this issue have been going on and the U.S. has made two serious problematic demands. The first is that any inventions and discoveries achieved in the U.S., regardless of the nationality of the inventor, will belong to the U.S. The second is that in the U.S., there is a volume of knowledge that is militarily classified and Japan should accept the notion of classified military knowledge and give statutory recognition to it. The first demand is quite against what is accepted practice in academic circles, where it is believed that a discovery or invention belongs to the scientist. It is an outrageous notion to maintain that the discovery should belong to the territory. Also, the statutory protection of classified military knowledge is quite impossible for a country like Japan. We see these demands as being quite outside the bounds of common sense.

Therefore, the narrow and arbitrary nationalist position of the U.S., must be analyzed before we can come up with any concrete ideas for rules for the future, or for any common grounds for our discussion on technical and scientific friction.

H.E. English

I agree with you when you say that the individual should benefit from his invention and I think that there is a real problem because inventions have been corporatized and now we are talking about them been nationalized. It seems to me that the crucial question is the optimum reward for invention and how it should be defined. In international discussions, this question has not been properly addressed. All that we have seen is this claim against counterfeit trade, which is fair enough and should be regulated, but the notion of an optimum has not been examined. I would like to hear your opinion on the optimum reward for invention and who should get it.

Toru Yano

I have intentionally avoided this question because it is a separate issue and should be treated as such. The protection of intellectual property rights should be considered in a multilateral, rather than a bilateral framework, and should be discussed at the Summit, for example, or other multilateral forums. As you are well aware, protection of intellectual property rights is being asserted by the U.S. In President Reagan's recent State of the Union message, it is clearly delineated as one of the important policies of the U.S. But currently, intellectual property rights issues are being dealt with in a case-by-case manner. There has never been a general rule that is agreeable and acceptable to the U.S. The European countries also find this a problem and seem to think that general or multilateral rules should be established to govern it. I repeat that I am not talking about such a general framework of intellectual property rights but, instead, about the new stance adopted by the U.S., that is techno-nationalism in its bilateral relations with Japan.

Jim MacNeill

I agree that this phenomena you describe is alive and living in the United States, as well as in other countries, and that it is giving rise to friction between the U.S. and Japan and some European countries. However when I look down the road I feel that the most serious friction will be between the industrial and Third World countries. My question deals with the notion of techno-globalism and your phrase—"international public goods with universal characteristics". What are some of these characteristics in your mind and how might the advanced industrial countries deal with the future demands of the Third World in the realm of science and technology?

Toru Yano

When it comes to economic cooperation for conventional types of technology transfer we are accustomed to cooperation, but when it comes to advanced science and technology and diplomacy *vis-à-vis* the Third World, then the question assumes a different nature. Unfortunately there are some developing countries that do not know pure mathematics, or sophisticated sciences such as space physics. This type of advanced knowledge has not been well transplanted to the Third World. A world order of advanced science and technology does not yet exist. However, a world order of rich man's science and technology does exist, giving us the acronym, WORST. We have the worst only! The dilemma is how to remove the "R", which will lead us to a multilateral order for science and technology (MOST) and better position the Third World in this issue of science and technology diplomacy.

The science and technology friction going on between the U.S. and Japan, and the rhetoric used by Japan against the U.S., might, in the future, be used in the same manner by the developing countries against Japan. Take the NICs, for example. If those countries are placed in the same position as Japan is *vis-à-vis* the U.S., they are likely to use the same rhetoric that Japan is using right now. Japan should assume a more universal position. We have to be prepared for the future. There is a possibility that NICs will blame Japan for their less than desirable position in the areas of science and technology. So, the present situation in technology friction between Japan and the U.S. has a very subtle implication in the future, for which we will need to develop a better understanding.

Atsushi Shimokobe

When we look at the state of science and technology today, the most important thing is the relationship between invention and innovation. There is a direct relationship between the two acts. In the past, invention has been achieved solely in the academic field and this has led to the receiving and giving of Nobel prizes and so forth. But, given the current situation in science and technology, it seems that invention is encouraged solely through the innovative process. Japan has traditionally not been very good at invention, but when it comes to making a direct connection between invention and

innovation, or *vice versa*, it has been rather capable. The U.S. may be first innovator in a given field but immediately after the technology is invented or innovated it is transferred to Japan or other countries, including those in the Third World. But what is the return of the original investment by the U.S.? I think that there is, to a certain extent, a reason for the U.S. to be worried, because other countries have not made any investment in the initial invention. Despite this feeling, I don't think that there is anything wrong with being a free-rider, especially if the free-rider is a nation in the Third World, because it may play a positive role supporting or developing innovation. But then you may ask: Who is going to pay for the investment made by the first inventor? Recently, I had discussions in Europe about corporate competition and this matter was an important focus of conversation. The connection between innovation and invention and the competitive edge of different corporations was discussed very seriously. I think this is going to be less and less of an issue in the future, because of the very short lag between invention and innovation, which is going to be a year, or six months, or even less. Ultimately, I think what must be created is a harmonious corporate culture and we should be more concerned with its development than with competition over different technologies.

Japan–Canada Relations in Perspective

Mikiko Iwasaki
University of Tsukuba

Introduction

Relations between Japan and Canada have evolved with few problems and frictions. This, however, does not necessarily mean that the two countries have developed a close and intimate relationship. The purpose of this paper is two-fold. The first objective is to offer a framework with which to analyze the state of Japan-Canada relations. It will elucidate why the two countries have failed to develop closer and deeper relations in proportion to the length of their relationship. Assumed in this problematique is the presence and influence of the U.S. on Japan-Canada relations. This assumption places the Japan-Canada relationship in the context of a Japan-Canada-U.S. Triangle and constitutes its background.

The second objective is to identify the possibility of achieving more intensive relations between the two countries. The paper will also discuss the impact of the Canada-U.S. Free Trade Agreement on Japan-Canada relations in the context of the developed framework of analysis.

Japan-Canada Relations

Significant developments in Japan-Canada relations did not begin until the 1970s. The background of this development can be analyzed from both Japanese and Canadian perspectives.

On the Canadian side, Canada has shown increasing interest in Japan and the Pacific countries of Asia, and its participation in Expo '70 in Osaka provided an early opportunity to change Canadians' image of Japan. On Canada Day at Expo '70 (May 28), Prime Minister Trudeau stated that Canada would refer to Japan "not as the Far East, but as our New West."

Canada's new pan-Pacific Policy, which placed greater emphasis on the importance of Japan, was the consequence of four factors, the first of which had its roots in Canada's domestic politics. The trade pattern between Japan and Canada has been characterized by Canada's export of raw materials to Japan and Japan's export of manufactured goods to Canada. As western provinces are the major producers of the materials that Japan imports, Japan has a closer relationship with Western Canada than with Central and Eastern Canada. Trudeau's Liberal party, however, suffered from the lack of support in Western Canada. The combination of these circumstances lead to the assumption that Canada's emphasis on Japan was partially derived from the federal government's intention to alleviate the discontent that Western Canada has frequently expressed toward national economic policy.

Second, the personality of Canada's political leader affected its pan-Pacific policy. Trudeau exercised a great deal of influence on the development of Japan-Canada relations because of his personal philosophy and interest in Oriental civilization.

Third, the fundamentals of Canada's foreign policy also help explain her increasing interest in Japan and other Asia-Pacific countries. Canadian foreign policy has been based on the avoidance of overdependence on one country. When Great Britain's influence was greatest, Canada was eager to develop closer relations with the U.S. to act as a counterbalance. Today, the U.S. has the greatest influence, and Canada has tried to offset it by strengthening relations with Europe and establishing new relations with the economically dynamic Pacific countries in Asia.

Finally, Canada-U.S. relations must be mentioned. As a result of the "Nixon shocks", Canada adopted the "Third Option" in 1972, in which it would "pursue a comprehensive long-term strategy to develop and strengthen the Canadian economy and other aspects of national life, and in the process to reduce the present Canadian vulnerability." Thus, the "Third Option", which focused on the idea of diversification, caused Canada to turn her eyes to Japan and other Pacific countries.

On the Japanese side, the development of Japan-Canada relations in the 1970s can be explained largely as a reaction to the "Nixon shocks", which were represented by the sudden announcements of Nixon's intentions to visit Beijing, the floating of the U.S. dollar, the imposition of a 10 percent surcharge on foreign imports, and the threat of

compulsory quotas on Japanese textiles. These "shocks" forced Japan to rethink her basic foreign policy posture.

The energy crisis of 1973 also provided an incentive to upgrade Japan-Canada relations. Japan was eager to diversify its purchases of energy and minerals from exporting countries in order to assure a stable supply. Because of its abundance of resources and political stability, Canada became more important to Japan.

Political highlights of Japan-Canada relations in the 1970s were Tanaka's 1974 visit to Canada and the resulting Tanaka-Trudeau Joint Communique on deeper and closer relations between the two countries; and Trudeau's 1976 visit to Japan, and the signing of two documents—"Outline of Japan-Canada Economic Cooperation" and "Japan-Canada Cultural Agreement"—to incorporate the 1974 Communique.

In general, Canada seems to have taken the initiative in the development of Japan-Canada relations. While Canada has shown explicit interest in Japan, Japan has tended to be rather passive in her attitudes to Canada, with the exception of the Tanaka-Trudeau Joint Communique. This difference in attitude derives largely from differing perceptions of the U.S. (The presence and influence of the U.S. on Japan-Canada relations will be discussed later.)

As mentioned, Japan-Canada relations have generally evolved without major problems and frictions. This fact, however, should not be appreciated unconditionally. First, it should be recognized that disputes and frictions do not usually occur when a relationship is not particularly close or intimate. Compared with the length of their interactions, Japan-Canada relations are not deep and have only become more substantive in the last two decades. Even recent relations have been characterized, on the one hand, by a perception gap as to the importance and expectation that each party has toward the other partner and, on the other hand, by the low availability of reliable information about each other.

Second, it is clearly desirable to strengthen the base of cooperation while the two countries are not in conflict, rather than to take measure of the importance of the partner only after facing serious problems. However, the tendency to take reciprocal cooperative action only when immediate interests are concerned seems to block this type of development.

Finally, even if Japan-Canada relations have few problems now, the seeds of future trade disputes have already started to germinate. Until 1983, the balance of payments between the two countries was in Canada's favour. However, in 1984, Canada registered a trade deficit with Japan and since then the trade balance has been in Japan's favour. If Japan's surplus with Canada continues to grow, and Canada's access to Japanese markets does not improve, bilateral trade disputes might poison future relations.

North Pacific Triangle: The Presence and Influence of the U.S. on Japan-Canada Relations

As has been pointed out, relations between the two countries are relatively shallow and are characterized by differences in attitude between the two countries toward the relationship. These facts are implicitly related to the presence and influence of the U.S. on Canada, Japan and their relations, because the U.S. is the most important partner to both countries.

American influence *vis-à-vis* Japan, and its relationship with Canada, has been exercised in different ways. At the political level, American influence is explicitly observed in Japan's foreign policy. Japan has focused its attention on the superpower, making the U.S. the cornerstone of its foreign policy, while paying little attention to middle-powers.

Geography also helps explain Japan's passiveness toward Canada. Canada shares the same continent with the U.S., making it the neighbour of the most powerful country in the western world. Subsequently, Japan-Canada relations are somewhat placed in the shadow of Japan-U.S. relations. Japan tends to treat her relationship with Canada as a part of her relationship with the U.S. If Canada were located in the middle of the Pacific, or at least further away from the U.S., Japan's perception of its importance would undoubtedly be different.

American economic influence on Japan is incorporated in two ways. First, the fall in value of the U.S. dollar and the appreciation of the yen has forced Japan to restructure her economy. Second, as a result of huge trade surplus with the U.S., Japan has been the victim of excessive American protectionism.

American influence on Canada is also observed in many ways, but its economic influence is most relevant to Japan-Canada relations. Canadian economic policy has oscillated between nationalism and continentalism. Prime Minister Trudeau's economic policy emphasized nationalism, while that of current Prime Minister Mulroney is more continental in nature, with the recent Canada-U.S. Free Trade Agreement, signed in January 1988, being a most explicit form of this continentalism.

Considering the extent of American penetration in the Canadian economy, in terms of the amount of capital investment and trade flows, North American economic integration will certainly be accelerated by a bilateral free trade agreement. Canada has explained that the Agreement, which will create the biggest free trade area in the world, is based on the principles of multilateralism and will not discriminate against off-shore countries. However, Japan does see some risk of the establishment of a North American block economy, especially since its auto industry provisions seems to break with the spirit of international trading rules. It is probably too early to predict, or estimate, the effect of the Agreement but, if it comes into effect as planned, it will certainly have an impact on the Japanese economy and Japan-Canada relations.

There can be little doubt that the influence of the U.S. on Japan, Canada, and their bilateral relationship is significant. Despite the fact that U.S. complaints against Japan focus on borders or barriers, while its relationship with Canada is based on the absence of

borders, it is important to stress American influence on Japan-Canada relations, because the United States remains the most important partner of both countries.

The Future of Japan-Canada Relations

International interdependence is accelerating in the western world. This interdependence has two different aspects. On the one hand, there is bilateral interdependence in which trade between two countries is relatively balanced and there is positive economic policy coordination between them. This is known as "symmetric interdependence". On the other hand, there is unilateral interdependence resulting largely from a trade imbalance. In this type of interdependence, one country's economic policy, especially trade policy, may have an intentional or unintentional negative impact on another's policy. This can be described as "asymmetric interdependence".

When relations between Canada and Japan are observed from this standpoint, they can be seen to be based on symmetric interdependence, in that there is no negative, unilateral action on the part of one party. But this does not lead to the conclusion that relations are based on a high level of mutual understanding. While it is true to say that Japan-Canada relations have been, for the most part, problem free, it is necessary to re-emphasize that the absence of bilateral problems does not mean the two countries are necessarily close.

The relationship should be analyzed in the broader context of a Japan-Canada-U.S. Triangle. When Japan-Canada relations in this North Pacific Triangle are thought of in terms of symmetric and asymmetric interdependence, an interesting scheme is revealed: asymmetric interdependence is observed not only between Japan and the U.S. but also between Canada and the U.S. In contrast, the Japan-Canada relationship is characterized by symmetric interdependence. This means that the Triangle is distorted. If this distortion is left in place, Japan and Canada will continue to suffer from unilateral action taken by the U.S. The rectification of this distortion will be indispensable for the three countries to have a healthy base for the development of their relations. If Japan and Canada can successfully strengthen their relationship, it can play an important role as a counterweight to the asymmetry of the Japan-U.S. and Canada-U.S. legs of the Triangle.

An improvement of Japan-Canada relations can take place on three levels. On a government-to-government level, Japan and Canada should have closer consultations. On a business level, Japanese direct investments in Canada, especially in the manufacturing sector, will be important for the development of closer economic cooperation between the two countries. (Canada wants more direct Japanese investments in order to make Canadian industry internationally competitive. For its part, Japan is forced to invest overseas because of her trade surplus and the appreciation of the yen.)

There is also a need for more cooperation on a citizen-to-citizen level, involving academics and journalists. How much do Canadians know about Japan and how much do Japanese know about Canada? The answer to this question is, that the amount of

information each has of the other is far too little. It is ironic that the good state of Japan-Canada relations has been based on the lack of mutual understanding. What is missing for a closer and deeper partnership between the two countries is comprehensive, reliable information. Japanese society is homogeneous, while Canada has adopted multiculturalism. Japan is located solitarily in the east rim of the North Pacific Ocean, while Canada shares the same continent as the U.S. Japan belongs to the Oriental civilization, while Canada is an important member of the Occidental civilization. As there are many more differences than similarities between the two countries, having information to understand the differences is very important for the future of Japan-Canada relations.

In this sense, it is regrettable that the Social Science Research Council in Canada recently decided to abolish a bilateral exchange program with the Japanese Society for the Promotion of Science. It is also in this sense that the importance of this symposium co-directed by IRPP and NIRA should not be underestimated.

We can no longer depend on the routine flow of information, which is usually fragmented. Partnership is based on friendship, friendship is fuelled by mutual understanding, and mutual understanding requires knowledge about the partner. We should make every effort to fill this information gap about our peoples and social structures.

Conclusion

This paper has analyzed the background development of recent Japan-Canada relations, suggested a more relevant framework for its analysis, and identified what is necessary for the development of the relationship. The main points made are:

(1) Japan-Canada relations are characterized by symmetric interdependence and have evolved with few problems and frictions;

(2) This absence of problems does not necessarily mean that Japan and Canada have kept a close partnership;

(3) Both Japan and Canada lack knowledge and reliable information about the other;

(4) This lack of knowledge is largely the result of American influence, geography and cultural differences;

(5) As the U.S. remains the most important partner for both Japan and Canada, it may be more useful to analyze Japan-Canada relations in the context of a North Pacific Triangle;

(6) This Triangle is distorted by asymmetry in both Japan-U.S. and Canada-U.S. relations. Only the Japan-Canada leg is in symmetric interdependence;

(7) The rectification of the Triangle will bring gains for all the three parties and Japan-Canada relations can play an important role;

(8) Mutual understanding constitutes the base of future development of Japan-Canada relations. What is needed is the desire to understand each other, and more reliable information.

It appears that the importance of the U.S. in world politics and economics is changing and its postwar supremacy is in decline. The U.S. is now the "injured eagle" and has tended to accelerate unilateral action and protectionist measures based on exclusive national interest. With the world system in the process of a complete transformation, there is a greater role for countries such as Canada and Japan.

However, the importance and influence of the U.S. should not be ignored, since it remains the most important partner for both Canada and Japan. Instead, the two countries should try to create a situation where American influence is taken positively into consideration. The distorted North Pacific Triangle can be rectified by ever-increasing growth and importance of the Japan-Canada leg. This rectification will benefit the whole community of the Pacific Basin, as well as the three countries of the Triangle.

Comments

Rod Dobell

We have just heard a very interesting and illuminating analysis of the North Pacific Triangle involving Canada, U.S. and Japan. But, of course, Japan does have large neighbors in the U.S.S.R. and China, and I wonder if we might have some comments on the way in which Japan/Canada relationships might be developed if one sees them from the perspective of a broader geometric figure encompassing these, and perhaps other countries.

Atsushi Shimokobe

NIRA is currently involved in a symposium series that is examining the issues of the North Pacific from a multi-country perspective. At the first of these symposiums, Canadian prime minister Trudeau was one of the main speakers and he told a very interesting story from his experiences in Asia and I think that this story is relevant to the present discussion. He said that "the relationship between two big powers is like a fight between two elephants when they fight to the point that they both get wounded but not fatally." He then asked, "Do you know what happens to the grass on the ground upon which the elephants fought? The grass feels the pain and may die. So you should think about the grass on which the elephants fought." But this is not the end of his story. He went on to say that, "There was another couple of elephants and they didn't fight, they did

not engage in war, they were engaged in lovemaking, and they made love on the grass and they left. But even after they left, the grass felt pain and died. In other words, be it love or war, it is the grass on the ground that suffers and not the big powers or the elephants."

So the former couple of elephants were the U.S.A. and the U.S.S.R., but probably he meant that the latter elephants that engaged in lovemaking were Japan and the U.S. I think that what he wanted to point out is that out of Japan/U.S. friendship some people suffer. This was quite an interesting viewpoint and one that will be more and more important in the scheme of East/West and North/South relations.

Richard Simeon

I would like to ask Professor Iwasaki to compare Japan's relations with Canada and Australia, because, although there are a great many economic similarities, Australia is not a part of this North Pacific Triangle.

Mikiko Iwasaki

Australia is in many ways, Canada's rival *vis-à-vis* Japan, as both countries depend on natural resources exports. Although the economic scale is somewhat bigger in Canada, Australia has the advantage of being located in the middle of the Pacific. The relationship between Japan and Australia is characterized by interdependence. The latter is separated from other parts of the world and its relationship with Japan does not suffer from the overshadowing effect of Japan/U.S. relations. On the other hand, however, Canada is in a position to take advantage of its geographical location next to the U.S., something Australia cannot do.

Toru Yano

I would like to add to Professor Iwasaki's comments. The Japan/Australia relationship is not really a peaceful relationship compared with that which exists between Canada and Japan. There are frictions. Brisbane, in Queensland, was the stronghold of General MacArthur's anti-Japanese movement during the second World War. Even after the war, many Australians possessed an anti-Japanese feeling and this feeling has not yet been totally removed and from time to time outward manifestations crop up. Secondly, there have been relatively frequent trade frictions between Japan and Australia because Japanese trading companies sometime worked in violation of Australian trade and commercial practices. These frictions may indicate closer relations between Japan and Australia and offer proof of Professor Iwasaki's theory that close relationships bring about frictions, but they also reflect different historical backgrounds.

Another point that is often forgotten is that Australia's military strategy often casts Indonesia as an enemy. As a consequence, Japan must have a significantly different diplomatic policy *vis-à-vis* Australia, than it does with Canada.

Jim MacNeill

I am interested in how the Canada/U.S. Free Trade Agreement will influence how other countries, or blocs, will view Canada *vis-à-vis* the U.S. Professor Iwasaki noted that Japan/Canada relations are somewhat in the shadow of Japan/U.S. relations and that Japan tends to treat her relationship with Canada as part of her relationship with the U.S. I think the same is true of the EC's perception of Canada, although maybe not so much the United Kingdom or France. My question is whether, in your mind, the Free Trade Agreement will inevitably reinforce this tendency by Japan to view her relationship with Canada as part of her overall relationship with the U.S.? And, if so, what are the consequences and also, what do you think Canada might do to compensate?

Mikiko Iwasaki

1984 was a significant year for Canada-Japan relations for three reasons. First, the amount of bilateral trade between the two countries exceeded $10 billion in that year; second, although Canada had been one of the rare countries which had traditionally registered a trade surplus with Japan, in 1984, Canada's balance of payments position with Japan shifted from surplus to deficit; and, third, a significant change in economic orientation at the federal level accompanied the 1984 change from a Liberal to a Conservative government. The previous Liberal governments adopted a "nationalist" or "anti-American" economic policy, and Canada accordingly turned its eyes to the Pacific in order to diversify its trade. In contrast, the current Conservative government advocates "continentalism" and has negotiated a Free Trade Agreement with the U.S. This Agreement will strengthen integration of the North American economy and Canadian interests in Pacific countries will be reduced.

I think the Agreement will, as you say, increase the difficulties for Japanese people to distinguish Canada clearly from the U.S. Although Canada is an active advocate of GATT, it has chosen to emphasize bilateral negotiations with the U.S. for the time being. If you take a look at the results of the negotiations, they were positive for Canada in that its bilateral relationship with the U.S. was reinforced. However, because of this success, Canada seems to be on a path leading to more consolidated integration with the U.S. Unfortunately, this reorientation will cast Japan into the role of a "fifth wheel" and will not aid the promotion of Canada/Japan relations.

I would like to ask my Canadian colleagues if Canada has abandoned the "Third Option" policy?

H.E. English

Yes, but I don't think that we can ever afford, economically or politically, to abandon our interest in third parties, no matter what political party is in power. My biggest concern is that business, not government, will, for the short-term, neglect trans-Pacific relations because of the preoccupation with American opportunities.

Thomas Wilson

One frequently cited handicap for Japanese industries contemplating direct investment in Canada is its limited market. Do you feel that the Free Trade Agreement will remove this handicap and might actually encourage additional foreign direct investment by Japanese companies in the Canadian economy?

Mikiko Iwasaki

As long as this Agreement does not discriminate against third countries, then the Free Trade Agreement means access to the U.S. market and it should be considered positive. However, offshore countries of auto manufacturing have been excluded from the Free Trade Agreement so, for this particular industry, investing in Canada wouldn't mean much.

Thomas Shoyama

Sometimes people in Japan have some difficulty with Canada because of its federal nature. Could you please comment?

Mikiko Iwasaki

The federal system of Canada makes it more difficult for the Japanese to understand the Canadian way of doing things and this may be one reason why the Canada/Japan relationship is not sufficiently close. For example, if the province of British Columbia makes an arrangement for Japanese corporations to come to B.C. then these corporations will also be subject to the federal jurisdiction. The overlapping, or co-existence, of federal and provincial restrictions makes the Japanese somewhat misguided because we are not used to this kind of double system. The complexity of federal/provincial jurisdictions is not even fully understood by Canadians and it is certainly more difficult for the Japanese. In addition, there are quite different relations between provinces and the federal government. The relationship between the federal government and the province of B.C., or that with Quebec or Ontario, may differ in character. There may be provinces that are on good terms with the federal government and others that are not. This again is rather hard for Japanese to understand. Furthermore, each province has its specific history and characteristics. Finally, both the U.S. and Canada have federal systems, but the

provincial powers are stronger than those possessed by the American states. This is also difficult to understand and, of course, makes corporate activities more difficult.

Toru Yano

Professor Iwasaki referred to the problems that Japanese have understanding the Canadian federal system. Although I agree with this proposition, I would like to alleviate Canadian concerns by adding, that compared with five years ago, Japanese people have become more accustomed to handling federal systems. We have had much recent experience dealing with the American system as a result of the unitary tax issue. And, as pointed out, we have a close relationship with Australia, which has a federal system that is probably more incomprehensible than the Canadian. So we should not be too concerned about Japanese understanding of federalism.

Canada's Economic Prospects Over the Medium Term

*T. A. Wilson**

I Introduction

This study presents and discusses projections for the national economy through 2001 prepared under the auspices of the Policy and Economic Analysis Program (PEAP). The projections were finalized in late November 1987 and make use of national accounts data through 1987:2.

In the broadest outline the projection resembles earlier PEAP medium-term analyses: the economy moves gradually toward full employment, with real growth at or above potential, inflation is not seriously reignited, and the federal deficit—and later the federal debt—fall gradually as a share of GNP. However, the current projection differs from earlier ones in two important aspects: it incorporates both phases of tax reform and assumes that a free trade agreement (FTA) with the United States will be implemented. The FTA will provide a significant long-term boost to growth, both through the investment needed for restructuring and through improvements in productivity from

---

* This paper draws on three studies which I have carried out in collaboration with colleagues in the Policy and Economic Analysis Program: "National Projection Through 2001: Base Scenario And Short-Term Alternatives" University of Toronto Policy and Economic Analysis Program, Policy Study No. 87-3 (with Peter Dungan and David Fujimagari); "Macroeconomic Effects of the Canada-U.S. Free Trade Agreement", University of Toronto International Economics Program Working Paper, DP 88-18 (with Peter Dungan) and "Macroeconomic Effects of Tax Reform in Canada, *Canadian Tax Journal* Vol. 30 No. 1 pp. 110-123 (with Peter Dungan). I thank the Canadian Tax Foundation for permission to reproduce sections of that paper.

As with all papers dealing with current policy in an "outlook context", this study is rapidly overtaken by events. The temptation to continue revisions to take account of new developments has been resisted, however: this paper describes the outlook as of April 1988, the time of the joint workshop for which it was prepared.

industrial rationalization. The projection therefore features a higher growth path through the 1990s than found in earlier PEAP projections.

II Assumptions and Factors Underlying the National Projection

This section outlines and discusses the principal assumptions in the National Projection. These include assumptions about the economic prospects of Canada's major trading partners, and about Canadian fiscal, monetary and exchange-rate policy. (Readers who wish to examine the numerical assumptions incorporated in the projection are urged to write the publisher for a statistical annex to this paper.)

II.1 The Foreign Environment

This projection was prepared, immediately following the "Black Monday" stock market crash of October 19, 1987 and subsequent severe depreciation of the U.S. dollar. U.S. economic forecasts following the crash were for real growth below 2 percent, and our projection for 1988 was reduced to 1.6 percent. However, the subsequent strong momentum of the U.S. and Canadian economies in the fourth quarter of 1987 and the first quarter of 1988 indicates that the stock market crash proved to be a most inaccurate near-term leading indicator. Current Canadian and U.S. short-term forecasts are for real growth near 4 percent in 1988. However, there is also a consensus that real growth will slow considerably in 1989 or 1990.

Another aspect of our projection which has been thrown off by recent events is the Canadian dollar exchange rate. We had projected a very modest appreciation to 76 cents U.S., whereas the Canadian dollar has recently traded above 81 cents U.S.. Even if there is a retrenchment later in the year, the average exchange rate for 1988 should come in at least at 80 cents.

Although the near-term results will be modified in our next projection exercise, the basic character of the medium-term projection is unlikely to be altered dramatically. As the economy moves closer to full employment, supply side factors largely determine the growth path.

The U.S. projection used in this study is a mixture of elements from recent projections by Project LINK and by Data Resources Inc (DRI). For details see Charts 2A and 2B. The U.S. projection entails real growth at potential (an average of about 2.5 percent) over the projection interval. Inflation holds steady at just over 3 percent in 1988 but increases to above 5 percent over the next five years. Inflation then remains somewhat above 5 percent through the remainder of the projection. The real 'AAA' industrial bond rate is 6.8 percent in 1988 using the 1988 inflation rate but is closer to 5 percent if the widely believed projected rise in inflation is assumed. In the latter case, the

real rate drops only moderately to about 5 percent in the early 1990s. On the other hand, the real short rate is only about 1 to 1.5 percent through the 1990s.

The projections for three of Canada's major OECD trading partners outside the United States (Japan, United Kingdom, Germany) are also based on a mixture of Project LINK and DRI estimates. The projections show pronounced depreciations of the U.S. dollar against other major currencies in 1987, with the declines continuing into 1988 when measured on a year-over-year basis. After 1988, exchange rates move largely to maintain purchasing-power parities. Based on Canadian export weights, the currencies of Japan, Germany and the U.K., plus the U.S., appreciate about 17 percent against the Canadian dollar through 2001—more than half of which is the result of appreciation by Germany and Japan against the U.S. dollar.

II.2 Demography

The population and household projections incorporated into this version of the PEAP national projection have been prepared using the most recent projections from Statistics Canada. The population projections are taken from the Statistics Canada publication, *Population Projections for Canada, Provinces and Territories: 1984-2006*, (Ottawa: May, 1985), while the corresponding household projections are taken from the Statistics Canada publication, *Interim Households and Family Projections for Canada, Provinces and Territories to 2006* (January, 1987).

The projection uses the Statistics Canada "low-growth" scenario, deemed by the authors to be the "most plausible" course for the short-term. Under the assumption that the population trends of the early 1980s are likely to continue into the next decades, total population is projected to grow at a decreasing rate, reaching 0.3 percent by 2001. Over the same period, the aging trend in the population will become more pronounced as the size and proportion of the young and elderly groups move in opposite directions.

By the early 1980s, fertility rates had declined to an all-time low. The national fertility rate for Canada had fallen from 2.19 in 1971 to 1.82 in 1976. By 1981, the fertility rate reached a low of 1.7. Several factors contributing to this decline in fertility are often cited. The role of women in the labour force has become more important over time with changes in social mores and economic conditions. With the increasing involvement of women in the labour force, women have opted either to have fewer or no children or to postpone childbearing. At the same time, marriage rates have decreased, while divorce rates have increased. Both trends have had a negative effect on fertility. Current indications suggest that fertility trends are unlikely to reverse significantly. Hence, the fertility rate for Canada is assumed to continue its decline from 1.7 in 1981 to a low of 1.4 by 1996, and to remain constant at that level thereafter.

A low fertility rate and moderate reductions in the mortality rate, coupled with annual net international migration of 50,000 throughout the projection period, result in a continued slowdown in population growth over the next few decades. Accompanying this

slowdown is a profound change in the age structure of the Canadian population, as the elderly increase both in numbers and as a proportion of the population. As the natural increase in population over time falls, with the fertility rate declining to sub-replacement levels and the aging trend in the population becoming more pronounced, immigration will become an increasingly more important source of population growth.

Households in the projection decrease in size (from 2.9 persons per family in 1981 to 2.4 in 2001), while household growth continues to outpace general population growth. Both phenomena are mainly the result of decreased fertility and an increasing share of the population living alone. Moreover, the number of non-family households is projected to grow more rapidly than the number of family households, and similarly for single-parent families relative to husband-and-wife families. Baby-boomers are major contributors to household growth, with the largest proportion of households being concentrated among those aged 35 to 54. Moreover, 31 percent of the projected household growth will be among those aged over 65, while those under 35 will experience a sizeable decrease in proportion.

The gradual aging of the source population for the labour force also has implications for the long-term equilibrium rate of unemployment; it falls gradually in the projection from about 5.9 percent in 1986 to about 5.6 percent by the end of the projection period. Note that no special upward adjustment has been made to the equilibrium rate to reflect necessary industrial restructuring or regional imbalances which, it might be argued, would tend to make the labour market tighter than it appears, both at present and through much of the projection, as the economy adjusts to free trade.

Several adjustments to the labour force participation rate equations have also been made, reflecting our judgements about the easing or termination of some long-term trends. The rise in participation of the 15-24 age group levels off in the mid-1990s to reflect increased returns to education to this group and a greater availability of education as numbers of young people decline relative to the size of the education sector. Most importantly, the long secular rise in the participation rate of females 25-54 is judged to come to an end when a level of 84 percent is reached in the late 1990s. The level of 84 percent was set rather arbitrarily as 10 percentage points below the very stable 94 percent participation rate of males 25-54. Finally, other more minor adjustments accelerated the reduction in participation rates for older males (55 and over) to reflect both enhanced early retirement, related to technological adjustments, and a gradual rise in the average age of this group.

II.3 Fiscal Policy

The projection incorporates both phases of tax reform. Phase I of tax reform is implemented in all its key features. A revised set of equations captures the new system of personal income taxes. Changing depreciation and statutory tax rates are phased in for

corporate taxes. Finally, special adjustments capture the impacts of the new telecommunications sales tax on foreign trade and consumer services.

Phase II of tax reform is assumed to begin in 1990. The existing manufacturer's sales tax and the telecommunication's tax is replaced by a federal VAT implemented at a rate of 8 percent. It excludes food but continues to tax alcohol and tobacco at effective rates of 15 percent. Personal and corporate surtaxes are removed, the sales tax credit is increased (by about $200 per adult), and three percentage points are subtracted (in two steps) from the rate for the middle income tax bracket.

The effects of the two phases of tax reform are considered separately in Section IV below.

Real current and capital spending by all levels of government rebounds from the very low growth rates of 1986 and 1987, but grows below the rate of GDP growth throughout the projection period. By the mid 1990s, as deficits diminish and social pressures increase, growth in real government spending does rise above 1.5 percent per year, and continues to increase through the projection horizon. Much of this additional spending acceleration is assumed to occur below the federal level.

Major improvements in the federal deficit situation by 1993 permit the re-introduction of full indexation. A combination of higher spending needs at the non-federal level and a robust tax intake at the federal level led us to assume a significant rebound from present rates in the growth of federal transfers to the provinces. These begin to rise in real terms in the early 1990s and become stronger still at the end of the decade.

The contribution rate to the Unemployment Insurance (UI) Fund is held constant from 1986 through 1993, gradually eliminating the deficit in the UI account. The contribution rate is lowered slightly thereafter as the fund moves into a surplus. Contribution rates for the Canada and Quebec pension plans are gradually increased in order to maintain modest surpluses in their accounts.

II.4 Monetary and Exchange-Rate Policy

The projection assumes a gradual narrowing of Canada-U.S. long-term and short-term interest differentials to levels significantly lower than those prevailing over the recent past (see Chart 2B). This assumption is in line with a projected narrowing inflation-rate differential between the two countries. However, this process takes almost three years. In effect we assume that, in the long-run, the Bank of Canada must eventually accept some depreciation of the dollar and some additional inflation for structural reasons (rising U.S. inflation, the transition to free trade and the inflation stemming from Phase II of tax reform). However, in the near term, significant interest rate differentials are maintained.

II.5 Free Trade

The projection assumes that the Canada-U.S. Free Trade Agreement (FTA) will be enacted in both countries, with implementation beginning as agreed in January 1989. Tariffs are reduced over ten years, direct investment inflows are augmented and the private investment equations are adjusted to reflect investment for restructuring and rationalization. Total factor productivity is adjusted to reflect the productivity improvements stimulated by the FTA. Estimates on the increments both to investment and to productivity follow the work of Richard Harris.[1] Our analysis of the macro-economic impact of the Free Trade Agreement is discussed separately in Section V below.

Other Adjustments

The inflation-rate differential *vis-à-vis* the United States was assumed rather than generated by the model (see Chart 2B). This differential is projected to be much lower than in the past because of relative slack in the Canadian economy through much of the projection period; despite this slack, it is maintained at a small positive level, just as actually occurred in 1985-87, even though the FOCUS equations alone would tend to project a lower Canadian inflation rate. In this case, model estimates for the future conflict with a strong "stylized fact" of the last two decades—and we have adopted a compromise.

The consumption equations of the model have been partly overridden to impose our own assumption about the behaviour of the inflation-adjusted savings rate. Making this assumption allows us to concentrate much of our attention in the key consumption sector on one figure, and it greatly facilitates the development of the projection by temporarily eliminating one element of simultaneous feedback. As it happens, when combined with all other elements of the projection, the model's consumption equations do not disagree in any important way with our assumed savings rate pattern.

Finally, one or more major energy-related investments with a total cost of about five billion 1981 dollars are assumed to commence in the early 1990s and to begin to reduce our oil imports (or increase our electricity exports) by the last three years of the projection.

III PEAP National Projection to 2001

III.1 Summary

The basics of the PEAP National projection are summarized in Chart 1. Very broadly the projection shows strong sustained growth, with the Canadian economy continuing to close the severe output gap opened in the early 1980s, and attaining full employment within the projection horizon. Moreover, thanks to productivity improvements engendered by rationalization under free trade, potential growth itself is significantly increased for a

number of years and labour productivity grows at levels unseen on a sustained basis since the early 1970s. As a result, the present projection shows a sustained rate of GDP growth at well above 3 percent for over a decade. This growth trend is significantly above those of some earlier PEAP medium-term projections. Inflation, meanwhile, shows a one-time spike in 1990-91 due to Phase II of tax reform, and then rises with U.S. inflation into the range of 5+ percent.

As will be seen below, the projection relies heavily on investment growth through the mid-1990s for the shrinking of the output gap that is attained in these years. Thereafter, the sources of growth become more diversified. As the deficit problem fades, governments need to put less of a drag on spending through their taxation and expenditure policies; also, as real wages rise with a lowered unemployment rate there is additional stimulus through higher personal income growth and consumption spending.

III.2 Comparisons with the U.S. Projection

Projection results for Canada and for the United States are compared in Charts 2A and 2B. The projection shows real growth (in GNP terms) in Canada falling slightly behind U.S. growth in the first two years as Canada absorbs the growth spurt of the last two years and as the savings rate decline, which has fuelled much recent growth, finally comes to an end. Thereafter Canadian growth is uniformly higher—in the mid-1990s by over a percentage point each year. This we do not view as surprising; the potential growth rate in Canada is higher than that of the U.S. and receives an additional boost through much of the projection period from total factor productivity growth associated with adjustment to free trade. Furthermore there is somewhat greater slack in the Canadian economy relative to the U.S. economy (which is now virtually at full employment). The higher Canadian growth in the 1990s is a reflection both of this higher potential growth and of a closing of the remaining output gap.

Inflation shows a small positive differential in the projection where historically (and certainly through the 1970s) Canadian inflation has significantly outpaced that in the U.S. The low differential assumed is based on the relatively greater slack projected for the Canadian economy.

III.3 Composition of Output; Income and Saving

The projection entails major shifts in the composition of aggregate output. Foreign trade is projected to rise faster than GDP over the whole projection interval. In part this represents a continuation of trends, as is shown in Charts 3A and 3B, but the implementation of the Free Trade Agreement also provides a strong boost to both imports and exports.

Over the next eight years, the share of GDP devoted to investment expands dramatically. Indeed, investment growth is so strong that its weighted contribution to GDP growth up to 1994 actually exceeds that of consumption (despite the fact that consumption accounts for a much larger share of GDP).

The investment strength is concentrated in business capital formation rather than housing. Business capital formation is stimulated by the investment required for rationalization and restructuring under free trade. Furthermore, as noted above, major energy related investments contribute to business capital formation in the early 1990s.

Growth in consumption is below that of GDP through the mid-1990s. By the late 1990s, however, the growth of personal income accelerates and consumption growth once again exceed the growth of GDP.

By assumption, government spending grows at rates considerably less than GDP growth. However, this projection is not significantly out of line with average government-spending performance from as early as 1974. With deficits less of a problem after the mid-1990s, a modest increase in the growth rate of government spending is projected for the later years.

Movements in income and saving, which underlie the broad movements in demand sketched above, show a long slow decline in the share of wages and salaries in national income. The major increase is in the share of property income—largely corporate profits; high real interest rates and weak labour markets mean a gradual rise in the income share of capital. Corresponding to these movements in income shares are shifts in the sources of net saving and finance (Chart 4). The importance of capital consumption allowances for gross saving naturally remains high. Personal saving gradually diminishes in importance with a lower real savings rate and with a falling share of personal income. Corporate retentions remain at about historical levels. Finally, government rapidly declines as a net sink for savings, and is even projected to make a small positive contribution at the projection horizon.

III.4 Wages and Prices

As shown in Chart 5, a significant gap between the actual and full-employment unemployment rates exists through much of the projection period but, despite this, the rate of inflation gradually increases after 1987. As noted above, this rebound in Canadian inflation is partly an assumption of the projection and is partly driven by the U.S. projection. In addition the implementation of Phase II of tax reform provides a transitory boost to inflation in the early 1990s.

Dynamic Phillips curve analysis suggests that at full employment (e.g., with non-accelerating inflation) real-wage gains should exactly equal labour productivity gains. Real wage gains will of course be less than productivity gains when unemployment is

above the full-employment rate. As Chart 6 shows, real-wage gains in the projection period are indeed below productivity gains until late in the 1990s.

III.5 Productivity and Employment

The projection features a growing and significant rebound of labour productivity from the nadir reached in the late 1970s and early 1980s. It is worth noting that a large portion of the productivity rebound is a model assumption—some of which represents the impact of rationalization under free trade and some of which represents other labour-saving technology enhancements being put in place, primarily with an eye on longer-term international competitiveness rather than on more short-run, domestic-relative, factor prices.

III.6 The Balance of Payments

This projection, in contrast with earlier PEAP projections, shows a pronounced deficit in the current account persisting through much of the projection period (Chart 7A). In effect, it could be argued that adjustment to free trade has prolonged the period in which Canada presents many lucrative opportunities for foreign investors and thus remains a significant net borrower on long-term account. At the projection horizon this situation is beginning to turn around with the current account and long-term borrowing both diminishing as a share of GDP. Short-term flows (plus errors and omissions) remain negative—as in most of the recent past—with their level as a share of GNP remaining within historical ranges.

As Chart 7B shows, the major movements in the current account are due largely to the merchandise balance. The balance on services other than capital service continues negative but levels off as a share of GDP. The negative capital-service balance worsens gradually as a result of sustained foreign borrowing to finance free-trade transition and major energy investments.

III.7 Government Deficits and Debt

It has been assumed that government spending will gradually diminish as a share of GDP (Chart 8). However, this assumption is not a drastic one; total spending as a share of GDP is projected to fall by 2001 only to mid-1970s levels. Charts 9A and 9B show greater detail for federal expenditures. As can be seen, the reduction in federal expenditure relative to GDP is founded primarily in transfers to persons (reflecting among other things a relative reduction in UI payments) and in interest payments, which begin to fall

sharply once the federal debt begins to fall relative to GDP. By the later 1990s there is room for current expenditures and transfers to provinces to rise slightly as a share of GDP. Finally, capital assistance as a percent of GDP falls to historical levels with the phase-out of the Petroleum Incentives Program.

Chart 10 shows the major federal revenue categories as shares of GDP. Most notable in this figure is the relatively small impact of tax reform on revenue shares of GDP when compared with past shifts in these shares. Tax reform has very little impact on the corporate share, which has actually fallen considerably from earlier decades. Tax reform does lower the ratio of personal taxes to GDP, but primarily it simply eliminates some of the increases in that share of the mid-1980s. Finally, Phase II of tax reform does raise the share of indirect taxes to GDP considerably, but not as far as to the levels of the late 1960s.

The projection for the federal deficit is shown in Chart 11. As can be seen, there is a steady decline in the federal deficit measured as a percentage of GDP. And when inflation adjustment is taken into account, the federal deficit is eliminated by the early 1990s.

Chart 12 shows both corporate and government borrowing requirements, together with their total. As can be seen, the reduction in government requirements due to revenue growth and expenditure restraint leaves sufficient room for the corporate requirements generated by a higher investment share in GDP. That the total requirements fall late in the projection is partly due to the decline in investment associated with restructuring, which is matched by a decline in borrowing from abroad.

Finally, Chart 13 shows past and projected ratios of the federal debt to GDP. The federal debt burden does peak (in 1990) and then diminishes under the assumed settings for expenditure and taxation. It would require much slower economic growth or much greater government spending growth for the debt/income ratio to continue to increase through the middle of the 1990s.

IV. Tax Reform and the Macro-Economy[2]

As noted, the medium-term projection incorporates two major policy initiatives; the Canada-U.S. Free Trade Agreement (FTA) and both phases of tax reform. The macro-economic effects of the FTA are examined in Section V. This section covers the impacts of Phase I and Phase II of tax reform.

The Conservative government's program of tax reform began with the corporate income tax modifications of the 1986 federal budget. Phase I of the current tax reform completes corporate tax reform and carries out a major restructuring of the personal income tax. The tax burden is also shifted from the personal income tax to the corporate tax in Phase I, and these income tax reforms are accompanied by a temporary tax on telecommunications services to maintain revenue neutrality.

Phase II would implement a major reform of the sales tax system. The federal government has proposed a national multi-stage sales tax as one alternative, which would involve replacing provincial retail sales taxes, as well as the federal manufacturer's sales tax (MST), by a national value added tax (VAT). However, at the time of writing it is unclear whether the provinces will agree to participate in this program. We have, therefore, modeled the alternative put forward by the federal government of a federal-only VAT, replacing the federal MST.

Although Phase II remains in the discussion stage whereas Phase I is about to be passed by Parliament, we thought it appropriate to analyze both, since the minister has clearly indicated that tax reform must be viewed as a package. We chose to examine the impact of a federal-only VAT, taking into account the exemptions for food and drugs announced by the minister in December 1987.

Phase I

Phase I involves the completion of corporate tax reform, with phased reductions in capital cost allowance rates (CCA) and other base broadening measures permitting significant cuts in corporate statutory rates. The federal statutory rate for large non-manufacturing corporations is to be reduced from 36 percent to 28 percent in 1988. The statutory rate for large manufacturing corporations will be reduced from 30 percent to 26 percent in 1988, and in three additional 1 percent stages to 23 percent in 1991. Canadian controlled private companies are to be taxed at a 12 percent rate, which represents a cut of 3 percent for most small businesses, but an increase of 2 percent for small manufacturers.[3]

The personal income tax reforms entail the wholesale replacement of exemptions by tax credits, the conversions of many deductions to credits, and a number of base broadening measures. The existing ten tax brackets (with rates ranging from 6 percent to 34 percent) are to be replaced by three brackets. The first $27,500 of income is to be taxed at a 17 percent rate, the next $27,500 at 26 percent, and income above $55,000 at 29 percent. Part of the aggregate income tax burden is to be shifted from the personal income tax to the corporate income tax. Whereas personal income tax revenues are to be reduced by $2.5 billion by fiscal year 1990-91, corporate taxes are to be increased by $1.5 billion in the same year.[4]

With the projected revenue reductions from individuals exceeding the increase in corporate tax revenues, interim sales tax measures are required to maintain approximate revenue neutrality in Phase I. These interim measures include a 10 percent tax on telecommunications services (except for basic residential access charges), a shift of sales taxes on some products to the wholesale level, and a 3 percent increase in the sales tax rate on alcoholic beverages and tobacco products to 18 percent. These measures are estimated to bring in $1.6 billion additional revenue in 1990-91.

While on balance Phase I is revenue neutral over the medium term[5], the timing of the implementation of the measures will augment the federal deficit by $1.3 billion in fiscal year 1989-90.

The fiscal and economic effects of the tax reform package will depend on the monetary policy pursued by the Bank of Canada. In our analysis of Phase I we examine two possible monetary policy strategies. In the first, the Bank of Canada acts to stabilize the exchange rate. In the second, the Bank of Canada maintains a money supply target.[6] In the discussion we shall emphasize the exchange rate target case, which we view as the more realistic, but will refer to results with the other monetary policy strategy as appropriate. When monetary policy acts to target the exchange rate, monetary adjustments required to neutralize any exchange rate effects of the tax policies will feed back onto the economy and thereby generate secondary effects on tax revenues and transfer payments.

Phase I: Fiscal Effects

As noted above, the Phase I package was designed to be revenue neutral. However, the revenue estimates presented in the White Paper and the Supplement do not allow for the impact of any tax changes on economic behaviour in response to the tax changes. These are therefore *ex ante* estimates of the revenue effects at given levels of incomes, prices, and interest rates.

When the tax changes are incorporated into the FOCUS model, a comparison of model solutions, with and without the tax changes, yields estimates of the fiscal effects of tax reform which include the indirect effects from any induced changes in the economy. The net fiscal effects of the package over the medium term depends on the assumed monetary policy. If the Bank of Canada adjusts monetary policy to maintain an exchange rate target, the Phase I package would generate a small reduction in the federal deficit over the medium term—in 1996 the deficit is reduced by about $ 700 million. On the other hand, if the Bank of Canada were to maintain a money supply target, the Phase I package would generate an increase in the federal deficit of about one billion dollars in the same year.

Both analyses indicate that the federal deficit would increase by two billion dollars or more in 1989. This reflects the delay of implementation of the Phase I personal income tax changes in withholding schedules to July 1, 1988, with consequent effects on final income-tax settlements in the first half of 1989.

Phase I: Economic Effects

With regards to the estimated macroeconomic effects of the Phase I package, the aggregate real output effects are very modest. Under a target exchange rate, aggregate real output is within 0.1 percent of pre-tax reform levels over the nine year period shown. This result reflects the offsetting effects of the changes of the major taxes. The personal income tax cuts stimulate consumption (which increases 1 percent by 1990) but the

corporate tax increases reduce investment by 1.5 percent in the same year. The new telecommunications service tax reduces international competitiveness, with the result that exports are reduced 0.2 percent and imports stimulated by 0.2 percent in 1990. Hence the tax reform shifts the composition of demand—away from investment and net exports and to consumption—with minimal impact on the *aggregate* level of demand.

Because of the interim increase in sales taxes, the aggregate price level is increased by 0.4 percent to 0.5 percent in 1990 under the target exchange rate. This positive price level effect is then gradually eroded as wages are depressed by the increase in the labour force. By the mid-1990s the price level effect has been eliminated.

These price developments feed back in turn on the components of demand. By 1996, the increase in consumption is reduced to 0.1 percent, reflecting the squeeze on real wages, and the foreign trade balance is improved, with real exports up 0.2 percent and real imports down 0.6 percent.

Under a money supply target, the initial upward pressures on the price level are blunted by an appreciation of the Canadian dollar. This appreciation is triggered by the effects of the tax-induced shift in the composition of demand (investment has a high import content) and by anticipations of lower inflation due to increased labour force participation. With the stronger dollar the real economy is weaker and the rate of inflation lower.

Phase I: Burden on Investment

Although the overall effects of Phase I are modest, the model results indicate that they will reduce investment. Over the medium term, investment in machinery and equipment will be hardest hit, being reduced by 2.5 to 3 percent relative to pre-reform levels. This result reflects two features of the Phase I package:

(a) The increase in the total corporate income tax burden: and

(b) The reduction in allowable CCA rates, which has stronger effects on new investment decisions than the statutory rate reductions that accompany them.

Whether the reduction in the aggregate value of investment is offset by an improved inter-industry allocation of investment cannot be determined by analysis with a macro-econometric model. However it is an unfortunate by-product of the Phase I corporate tax reform and the earlier phase-out of most investment credits that the tax burden has been shifted from old capital to new capital.[7] This increase in the inter-temporal distortions of the corporate income tax may unfortunately be as large in absolute size as the reduction in inter-industry and inter-asset distortions accomplished by tax reform.[8]

Phase II – A Prospective Analysis

As noted in the Introduction, Phase II remains in the discussion stages whereas Phase I is about to be passed by Parliament. In December 1987 the minister announced that food and prescription drugs would continue to be exempt from sales tax after Phase II reform. These exemptions, when coupled with commitments not to shift the relative sales tax burden on to municipalities, hospitals, and educational institutions, have probably eliminated the federal goods and services tax as a feasible alternative, since extensive exemptions and zero-ratings would necessitate an invoice-and-credit type of VAT.

Whether sales tax reform will include provincial participation in a national multi-stage tax cannot be determined at present. We have therefore chosen to model the impact of Phase II as a *federal* sales tax reform only. The MST and the telecommunications service tax are replaced by a broad-based VAT with food and drugs zero-rated, with residential rents exempt, and with no change in the sales tax burden on the provincial, municipal, hospital, and non-profit sectors.

The rate of tax under the new federal VAT would of course be lower than the 12 percent general rate under the existing MST since the rate is to be applied to a much broader base. However the new tax is also intended to bring in additional revenues in order to eliminate both income-tax surtaxes, reduce income taxes on middle-income groups, and provide enhanced sales tax credits. Using the FOCUS model we have estimated that a federal VAT at a rate of 8 percent would be sufficient to accomplish these objectives.

We assume that the Phase II sales tax reforms are put into effect on January 1, 1990. The two surtaxes are eliminated, and increased sales tax credits put into effect on the same day. The middle bracket of the personal income tax is reduced by 2 percent in 1990 and by an additional one percent in 1991, reaching a level of 23 percent, midway between the rates of the other two brackets.

Phase II will achieve a number of objectives. First, the sales tax burden on business inputs and business capital investments will be eliminated. Whereas under the present MST almost half the tax burden falls on business inputs and capital investments, the new VAT will exclude these completely through tax credits. Second, the present system's discrimination in favour of imports relative to domestic production will be eliminated. The removal of this tax distortion is particularly important as the Canada-U.S. Free Trade Agreement is phased in.

As a result of these changes the sales tax burden on exports and business investment will be eliminated, and the sales tax burden on consumption increased. Within the consumer sector, the tax burden on items presently subject to MST will be reduced somewhat, whereas the tax burden on items now exempt will be increased substantially.

The sales tax burden on residential construction will increase significantly. Under the present MST only building materials are subject to tax at a preferential 8 percent

rate; under the new VAT the labour component of construction as well as building materials will be taxed at the 8 percent VAT rate.

Phase II: Fiscal Effects

We have designed Phase II to be approximately revenue neutral on an *ex ante* basis over the first three years. However, when the Phase II package is implemented in the model, there is an increase in consumer prices as a result of the increase in indirect taxes and the shift of the tax burden from exports and business investment to consumption. The resulting increase in the CPI triggers two effects which tend to increase the federal deficit:

(a) increased indexation of transfer payments, such as family allowances and pensions, which raises government spending; and

(b) increased indexation of income tax credits, which lowers personal income tax revenues.

While the federal deficit is largely unaffected in the first two years of Phase II, the deficit thereafter worsens by up to almost $3 billion. Increased expenditures and indexation also worsen the balances of the provincial governments.[9]

Modelling Phase II: Wage and Price Response

A key determinant of the rate of change of money wages in the FOCUS model is the rate of change in the consumer price index (CPI), which is directly increased by the sales tax changes of Phase II. These sales tax changes involve two distinct shifts of the tax burden:

(a) the overall tax burden is shifted from personal and corporate income taxes to sales taxes; and

(b) the sales tax burden on exports and investment goods is shifted to consumption.

We believe that workers and employers will recognize that the portion of the increases in sales taxes that is offset by personal income tax reductions will not affect real after-tax take-home pay, and hence ought not to affect future wage bargaining. The FOCUS model was therefore adjusted to remove the wage pass-through of this portion of the CPI increase. However, the increase in consumer prices that reflects the shift of the tax burden from sales taxes on investment goods and exports to sales taxes on consumer goods, and from corporate income taxes to sales taxes on consumer goods, *should* trigger future wage increases, and does so in the model. This partial response of wages to the tax-induced rise in consumer prices will in turn stimulate further price increases and the model solutions capture these indirect effects as well.

In order to avoid adverse effects on real aggregate demand, the price adjustments induced by sales tax increases need to be at least partially accommodated by monetary

policy. In the FOCUS model such a partial accommodation can be accomplished if the Bank of Canada targets on the base-case exchange rate. We therefore analyze Phase II with this type of monetary policy.

Phase II: Economic Effects

The assumed Phase II package has initial effects on the composition of demand which are opposite to those of Phase I: investment spending is increased, net exports stimulated, and consumer spending reduced. However, the most dramatic effect of Phase II is on the price level. Even with the wage adjustment moderated as described above, the general price level is increased by about 3 percent by the late 1990s and the consumer price index by 3.7 percent. Most of these price level increases occur in the first four years.

The price level increases trigger indexing adjustments which generate additional fiscal stimulus as explained above. This moderates and then reverses the initial negative effects on consumer spending. As wages respond partially to the rise in prices, the initial improvement in international competitiveness is offset: real exports are therefore reduced over the medium term. As a result of the shift in the composition of demand to consumer durables and to machinery and equipment, real imports are stimulated.

Fortunately, the stimulus to investment persists. Machinery equipment spending is increased by about 1.5 percent on average, and non-residential construction by about 0.4 percent. However there is a negative impact on residential construction as a result of the increased sales tax burden on housing.

As a result of the indirect fiscal stimulus triggered by indexation adjustment, aggregate real output is increased by up to 0.3 percent in the late 1990s but, as with Phase I of tax reform, the chief impact of Phase II is not so much on the level of economic activity as on its composition.

Phase I and Phase II Combined

When the two stages of reform are combined, we obtain the picture presented in Charts 14 through 16. The gradual increase in the federal deficit provides a modest stimulus to real output. The negative impact of Phase I on investment is moderated but unfortunately not eliminated by the Phase II sales tax reform. The price level effects of the combined package remain important; however, it is noteworthy that these price level effects are largely of a "one-shot" variety and do not generate a persistent increase in inflation, even though the initial impacts on prices are partially accommodated by monetary policy.

V The Macroeconomic Effects of the Free Trade Agreement

Modelling Free Trade with the Macroeconomic Model

In our analysis with the FOCUS model, we have used Harris's estimates of the impact of the Free Trade Agreement (FTA) on total factor productivity, together with estimates of the investment required for rationalization and restructuring of industry.[10]

The estimated impacts of free trade on total factor productivity (TFP) were implemented in FOCUS by appropriate adjustments to the production function for the private sector. According to Harris, the best estimate of the long run effect of the FTA on TFP is 4 percent, with most of the gains being realized in the second five years of the ten-year transition period. The time pattern of the associated investment in rationalization and restructuring (R&R) has investment building up over the first few years, reaching a peak in the seventh year and then tapering off.

The estimated effects of R&R investment when incorporated into the FOCUS model *via* add-factors to the two investment equations. This was straightforward. However, the structure of the production function in FOCUS necessitated two further adjustments. FOCUS associates an "overhead" labour component with each investment in "plant" (non-residential construction and the overhead component of machinery and equipment). We felt it appropriate to eliminate this overhead labour effect, on the grounds that R&R would be associated with expansion of production from existing plants and/or increased specialization of existing plants, and hence should not require additional overhead labour inputs. Paralleling this adjustment, we assume, that the additional investment required to realize the TFP gains does not represent a net addition to the capital stock, and hence does not generate the normal marginal product of capital in addition to its contribution through raising TFP.[11]

Of course, estimates of the impact of the FTA on trade barriers themselves are required for the analysis. Estimates of the impact of the FTA on average tariff levels in Canada and the U.S., together with estimates of the tariff-equivalent effects of reducing non-tariff barriers (NTBs) are used to adjust effective export and import prices and customs revenues.

Other Policies

If the FTA were implemented with no other policy changes, the tariff revenues lost would provide a near-term fiscal stimulus to the economy. We have incorporated personal income tax increases which neutralize the impact of the FTA on the federal deficit.[12]

As the FTA has a favourable impact on aggregate output the budget position of the provinces would improve in the absence of offsetting policies. We assume that federal transfers to the provinces remain unchanged in real terms relative to the base case; since prices fall with the FTA in place, this entails a reduction in the nominal value of these

transfers. In addition, the provinces are assumed to reduce their personal income tax rates over time in order to neutralize the impact of the FTA on their budget positions.[13]

Even with these fiscal offsets, the FTA would have favourable demand effects, since it implements an indirect tax reduction which reduces nominal prices. Over the transition period, the FTA has favourable effects on investment which also contributes to aggregate demand. The improved productivity growth leads to increased aggregate supply, which is reinforced by any induced investment.

It is not clear, *a priori*, whether the FTA would shift aggregate demand by more or by less than aggregate supply over the medium term. Whether the shifts are in exact balance is, of course, not a critical issue since appropriate adjustments in monetary and/or fiscal policies could eliminate any imbalance over the medium term, and price adjustments should eliminate them over the longer run. In the central case, we have set monetary policy to maintain M1 at base-case levels, and, as already noted, have assumed revenue neutral fiscal policies. This simulation would therefore indicate whether, in the context of the FOCUS model, the FTA shifts aggregate demand by more than aggregate supply.

Variations in the exchange rate are the most important adjustment mechanism reconciling demand and supply of foreign currency. Since exchange rate policy is not affected by the agreement, and since the impacts on foreign trade are potentially large, we have allowed the exchange rate to float freely. The magnitude of the exchange rate changes provide an indication of the potential impact of the agreement on the balance of payments.

Other Adjustments and Assumptions

As noted above, the FTA will provide a real demand stimulus by reducing prices and stimulating the investment required for R&R. This demand stimulus will generate secondary effects on consumption spending and could induce additional investment to expand capacity. Over the first few years, whether the demand stimulus results in an appreciation or depreciation of the Canadian dollar depends critically on the fraction of the increased investment funded by net inflows of capital from abroad. We have assumed that half of the R&R investment is financed by increased net foreign direct investment. Given that R&R will be concentrated in the manufacturing sector, this assumption is not far out of line with the relative importance of multinational firms (domestic as well as foreign) in that sector. Half of the foreign investment is in turn assumed to be financed by foreign borrowing which entails future interest payments; the remainder is presumed to be equity based and wholly reinvested. The additional foreign funding stimulated by the induced investment (not associated with R&R) is generated by the capital flow equations of the FOCUS model after certain adjustments.

Modelling Price Expectations

Price expectations are important in three sectors of FOCUS. Long-term price expectations affect the real interest rates relevant for investment, and these price expectations also influence long-term international capital flows. Short-term price equations enter the wage equation. Since the "long-term" expectations are proxied by a two-year inflation forecast in FOCUS, the equations will overreact to certain kinds of policies. Furthermore, in the equation for non-residential investment, the real rate of return variable does not itself contain expectations of future rates of return. Hence changes (such as the TFP improvement) which reduce price inflation and improve real rates of return over the medium term, will not be handled properly by this equation.

To deal with these shortcomings we overrode both price forecasting equations, replacing the long-term equation by a reduction in inflationary expectations reflecting the long-term improvement of prices (exclusive of the TFP effect). This involved reducing price expectations by 0.25 percent per year, a change which was also roughly consistent with the exchange rate appreciation over the 13-year solution interval.

Only the short-term inflation forecast affects wages. We simply replaced the year-ahead forecast by the year-past realized inflation rate in the wage equation.

Exports

FOCUS distinguishes three categories of exports: petroleum and natural gas, automobiles to the United States, and other exports. Since trade between Canada and the U.S. for the first two categories is not currently subject to tariffs, the impact of the FTA is concentrated in the "other exports" category. The export demand equation for other exports depends on various foreign production variables and the price of Canada's exports relative to U.S. prices. However, other exports are composed of many primary commodities where the export prices are either established in world markets or through bilateral negotiations, as well as manufactured products where product differentiation allows for a certain amount of pricing discretion by firms. The FOCUS model has a switch allowing the user to set the fraction of other exports which are priced in world markets, for which the Canadian export price varies only with the exchange rate. For the purpose of the FTA analysis, we set the switch equal to .5, reflecting the relative importance of primary products relative to manufactured products in that category. We allowed the remaining exports of manufactured goods to be determined by the aggregate export equation.

Export Price Adjustments

For the half of other exports where the price is set by Canadian firms, the reduction in U.S. tariffs and the tariff equivalent reduction in U.S. NTBs was treated as a reduction in prices quoted in these markets, leading to an increase in demand at prevailing Canadian dollar prices. These adjustments were incorporated as add factors in the export demand equation. The indirect effects of the agreement on domestic cost and exchange rates also generate second round effects on export prices.

Import Price Adjustments

The reduction of Canadian tariffs and the tariff equivalent reduction of Canadian NTBs was treated as a reduction in import prices. Since Canada is treated as a price taker for all her imports, secondary effects of the agreement on import prices occur only *via* exchange rate changes.

Results: Macroeconomic Effects of the FTA

The estimates presented below represent what is, in our judgement, the average of the possible outcomes of the FTA. Perhaps too much emphasis has been attached to point estimates of the impact of free trade. Nevertheless, a discussion of these results provides a useful summary and a reasonable picture of the likely direction of the effects. The sensitivity of these results to variations in key parameters and policy assumptions will be examined in a forthcoming paper.[14]

The model results, represented in Charts 17 through 21, indicate that the Free Trade Agreement has significant positive effects on aggregate demand as well as on aggregate supply. Indeed, given our assumptions, the FOCUS model indicates that the stimulus to real demand is somewhat greater than the increase in potential output, so the unemployment rate is reduced somewhat over most of the 13-year period.

Over that period, real GDP growth is increased by just over one-third of one percent per year. At the end year, (2001) real GDP is 4.3 percent above base levels, and the unemployment rate is 0.2 percentage points lower.

The negative impacts of the agreement on the price level are somewhat stronger. Over the 13-year period the rate of inflation is reduced by 0.6 percent per year. At the end of the period prices are 7.4 percent below base-case levels. These price reductions reflect the effects of the reduction in import prices due to tariff and NTB reductions as well as the impact of productivity improvements on the unit cost of producing domestic goods.

The composition of demand shifts towards investment and foreign trade in the middle years and towards foreign trade and consumption in the later years. In the peak

period of investment stimulus (1994-98) real investment is up almost 5 percent. Imports are increased by more than 5 percent in those years, reflecting the impact of increased investment and relative price adjustments. Exports expand more slowly than imports in the early years, but by 1997 exports and imports are both up by 5.2 percent.

In the later years investment fades as the R&R investment is phased out. Exports boom with the realization of the improvement in TFP and hence in international competitiveness. Over the last three years real exports are up about 6 percent over base. Real imports are up 4.1 percent over the same period. Consumption growth, stimulated by reduced prices and increased real wages, is particularly strong in the last four years of the simulation.

The exchange rate experiences a mild depreciation in the mid-1990s when investment demand is strong and the current account of the balance of payments weak. By 1997, however, the dollar is above its base-case level and then continues to appreciate, reaching a level 2.8 percent above the base-case in the end year. This appreciation is associated with an improving current account, reflecting the improved competitive position following completion of the total factor productivity improvements.

The unemployment rate reductions are modest, since labour productivity improvements are occurring along with the real demand growth. The largest reduction in the unemployment, 0.4 percent, is achieved in the mid-1990s when investment demand is strong. The unemployment rate reductions then attenuate to 1999. In the last two years the unemployment rate effect strengthens. These are years following the completion of the TFP gains, so there are no further productivity increases to offset the employment effects generated by the additional expansion of real output.

VI Summary

This paper has combined a review of Canada's economic prospects over the period to 2001 with analyses of the effects of tax reform and free trade with the U.S. Canada's real growth performance over the next 13 years will likely surpass that of the U.S. The main reasons for this result lie on the supply side. The FTA should provide a significant boost to productivity growth for most of the period, and labour force growth in Canada is projected to be higher than that of the U.S. over the next ten years.

The composition of growth should be somewhat unusual over the next eight to ten years. The FTA will reinforce the historical tendency for trade to grow faster than output and the investment required to restructure Canadian industry under free trade will augment the normal cyclical swing in investment. The latter tendency will be further reinforced by major energy related investments in the early 1990s. As a result, growth will be investment-led and export-led over most of the projection interval.

Fiscal policy plays an accommodating role in these developments. The federal deficit is reduced steadily, with the result that declining government sector cash

requirements help to finance the expansion of business investment. The aggregate effects of the federal tax reform package prove to be relatively modest, except for a transitory increase in price levels accompanying the implementation of a federal value added tax under Phase II of tax reform.

Notes

1. Richard Harris, "Evaluating the Canada-U.S. Trade Agreement: The Economic Impact and Transition", University of Toronto, Policy and Economic Analysis Program, Policy Study No. 88-4.

2. Most of this section is taken from: Peter Dungan and Thomas Wilson "Macro-Economic Effects of Tax Reform in Canada". *Canadian Tax Journal*, Vol 36, No. 1 pp. 110-123. I thank the Canadian Tax Foundation for financial support and for permission to reproduce sections of that paper.

3. Part of the change from 1987 rate levels had already been enacted by the 1986 budget. The statutory rate for large non-manufacturing firms, for example, would have been reduced to 33 percent by 1989. The rate changes and revenue-impact estimates used in the model simulations are based on the incremental effects of the proposals of the White Paper as modified by the Supplement. (See Canada, Department of Finance, *The White Paper: Tax Reform 1987*, June 18, 1987 and *Supplementary Information Relating to Tax Reform*, December 16, 1987.)

4. All revenue estimates referred to in this paper are from Table 5.1 (p.75) of the White Paper, adjusted for the estimated effects of the December proposals from Table VI-2 (p.123) of the Supplement. We have treated the increase in refundable sales tax credits as a personal income tax measure. Where appropriate, estimates are adjusted to a calendar year basis.

5. Although there is a net increase in federal revenues, these are offset by increased transfer payments.

6. In the alternative, the Bank of Canada is assumed to maintain a target value for the narrowly defined money supply (M1). For a recent discussion of the roles of the monetary aggregates and the exchange rate in the formulation of monetary policy by the bank of Canada see John W. Crow, "The Work of Canadian Monetary Policy", Eric J. Hansen Memorial Lecture, Edmonton, University of Alberta, January 18, 1988.

7. For an analysis of the macroeconomic effects of the previous stage of corporate tax reform, which involved a phase-out of most investment credits coupled with statutory rate reduction, see Thomas A. Wilson and Mary MacGregor, "The Macroeconomic Effects of the 1986 Budget", *Canadian Tax Journal*, 34, pp. 563-587 (May-June 1986).

8. Hamilton and Whalley estimate that the relative gain from both phases of corporate tax reform averages only 0.01 percent of GDP. (Bob Hamilton and John Whalley "Efficiency and Distributional Effects of the Tax Reform Package", in John Whalley and Jack Mintz, Eds., *The Economic Impact of Tax Reform*, Canadian Tax Foundation, forthcoming 1988.)

9. The impact on provincial revenues of the reduction of the middle-bracket income tax rate is assumed to be offset by a modest increase of 1.75 percentage points in average provincial income tax rates.

10. As is explained by Harris, his estimates are derived using two models of the Canadian economy: a static general equilibrium model, and a medium term dynamic general equilibrium model. Richard Harris "Evaluating the Canada-U.S. Trade Agreement: The Economic Impact and Transition", University of Toronto, Policy and Economic Analysis Program, Policy Study No. 88-4.

11. This is implemented in FOCUS by preventing R & R investment from augmenting the capital stock. This may be rationalized on the grounds that building a plant of sub-optimal scale and subsequently expanding it to minimum efficient scale (MES) would typically cost more than building a plant of MES in the first place.

12. To be precise this is modelled so that there is no change in the federal deficit *ex post*, i.e. incorporating the direct and indirect effects of the FTA as well as the effects of the neutralizing tax change.

13. In the tables the consolidated budget balance position improves. This reflects an increased surplus for the Canada and Quebec pension plans.

14. See Peter Dungan and Thomas A. Wilson "Macro-Economic Effects of the Canada-U.S. Free Trade Agreement", University of Toronto International Economics Program Working Paper, DP 88-18.

Chart 1
Canada: Main Indicators

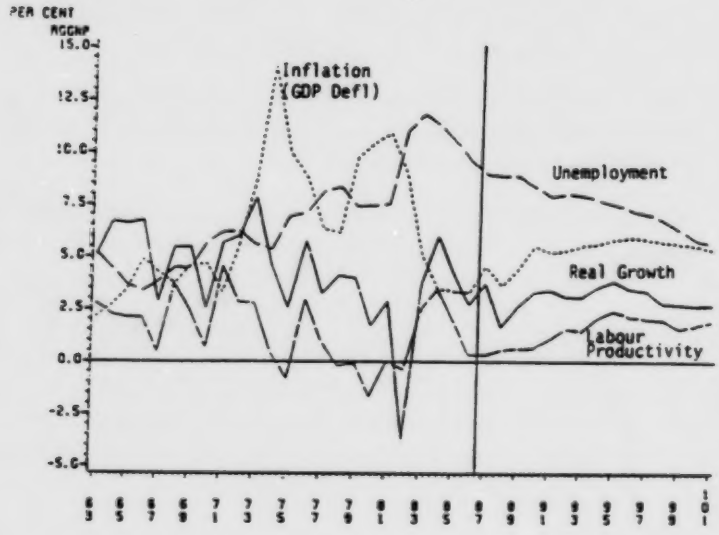


Chart 2A
Canada and U.S.—Growth and Unemployment

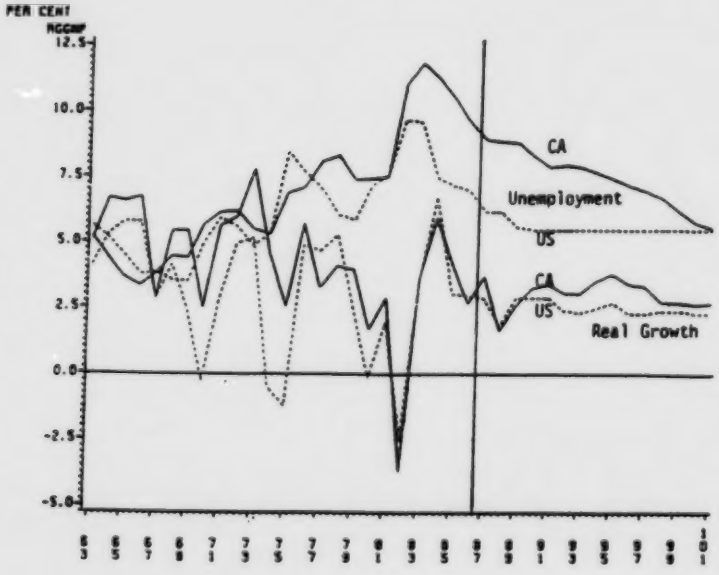


Chart 2B
Canada and U.S.—Inflation and Interest Rates

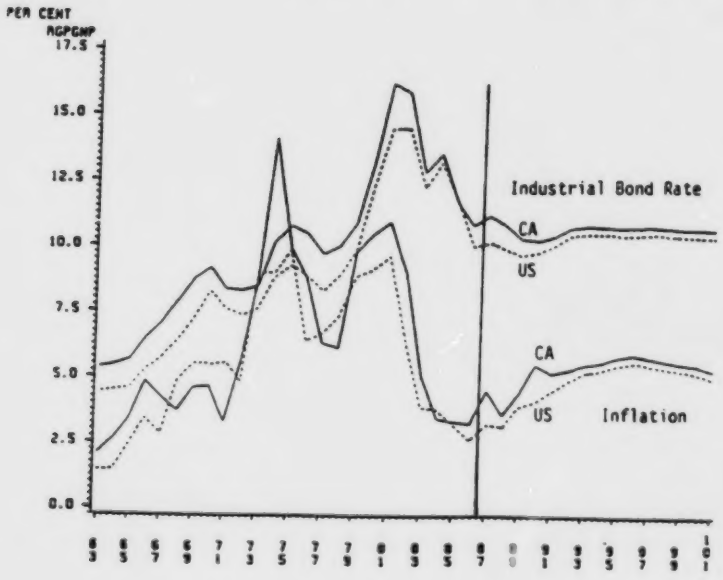


Chart 3A
Expenditure Shares of GDP

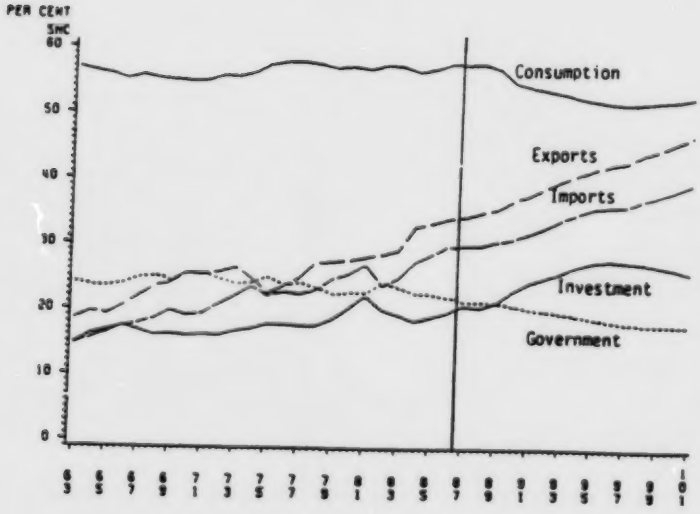


Chart 3B
Weighted Contributions to GDP Growth

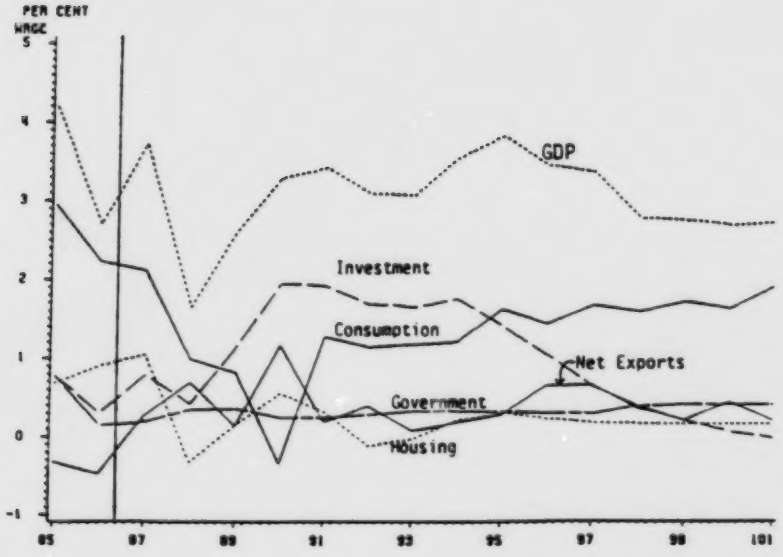


Chart 4
Shares of Total Saving

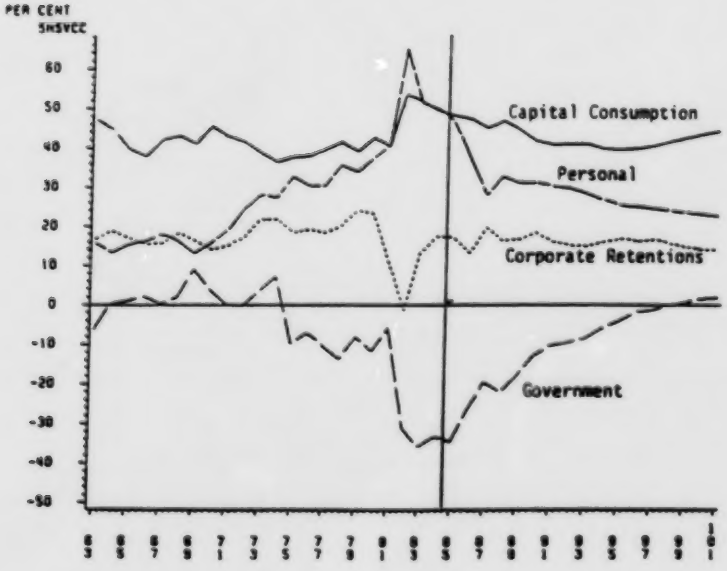


Chart 5
Inflation (CPI), Unemployment, and Full-Employment Rates

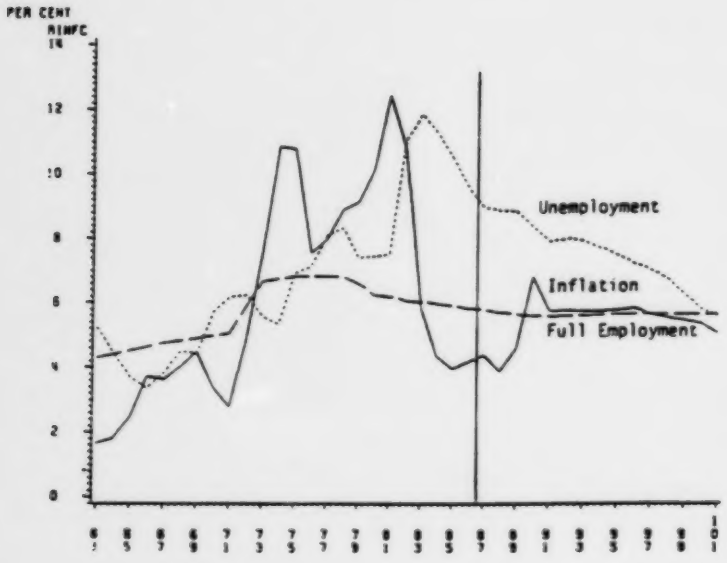


Chart 6
Real Wage Gains and Productivity Growth

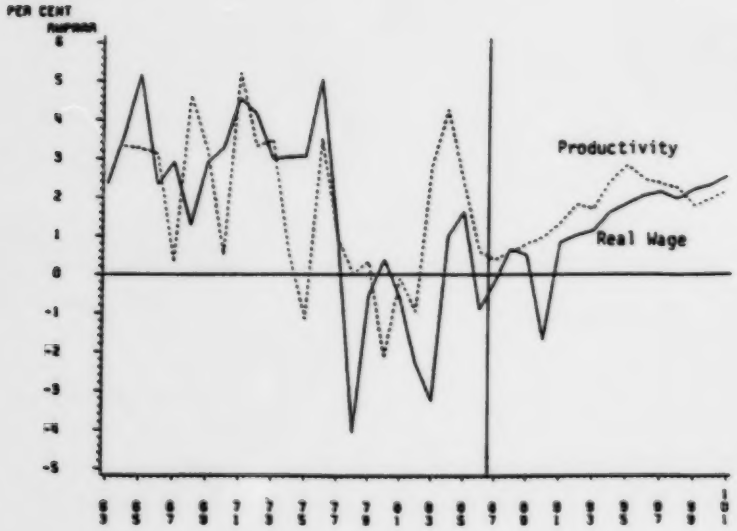


Chart 7A
Current, Long, and Short-term Balances
(percent of GDP)

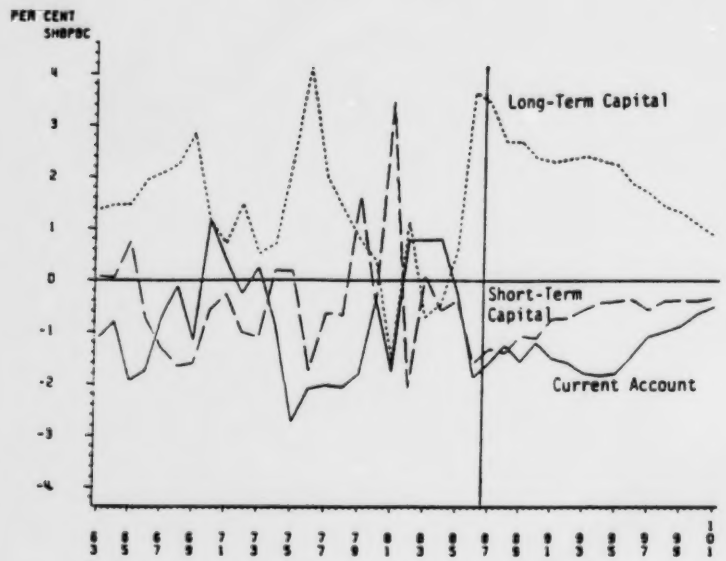


Chart 7B
Trade, Capital-Service and Other Service Balances
(percent of GDP)

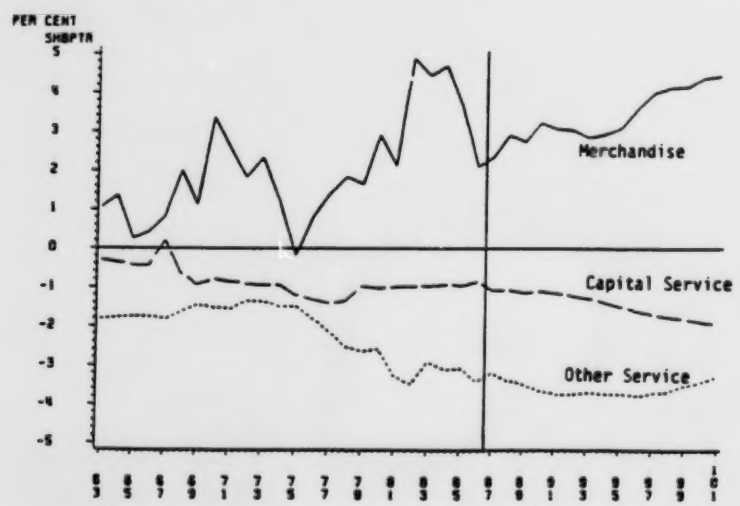


Chart 8
Government Total and Current & Capital Spending
(percent of GDP)

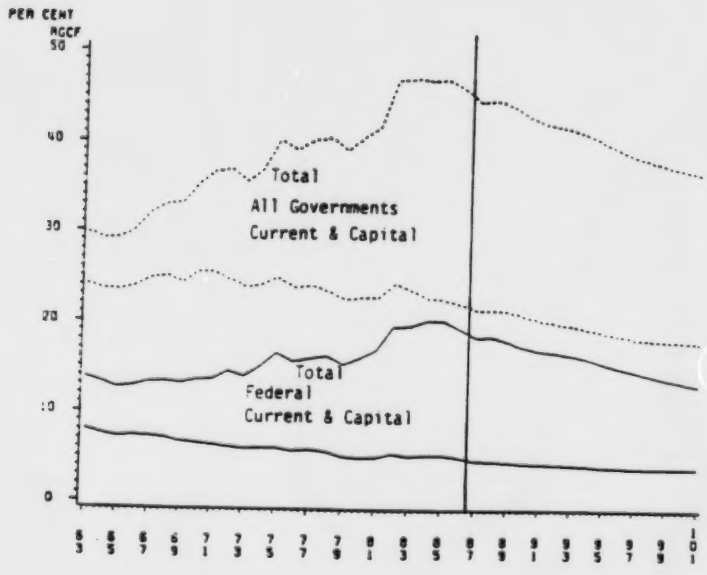


Chart 9A
Federal Expenditure Items: Percent of GDP

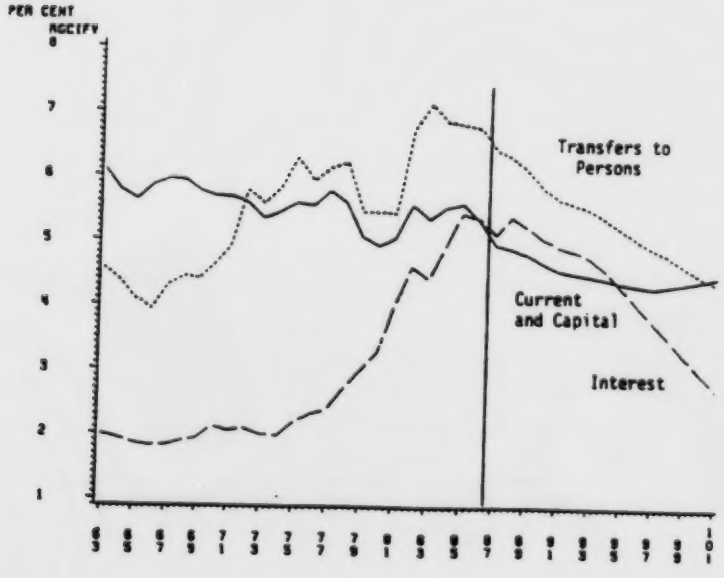


Chart 9B
Federal Expenditure Items: Percent of GDP

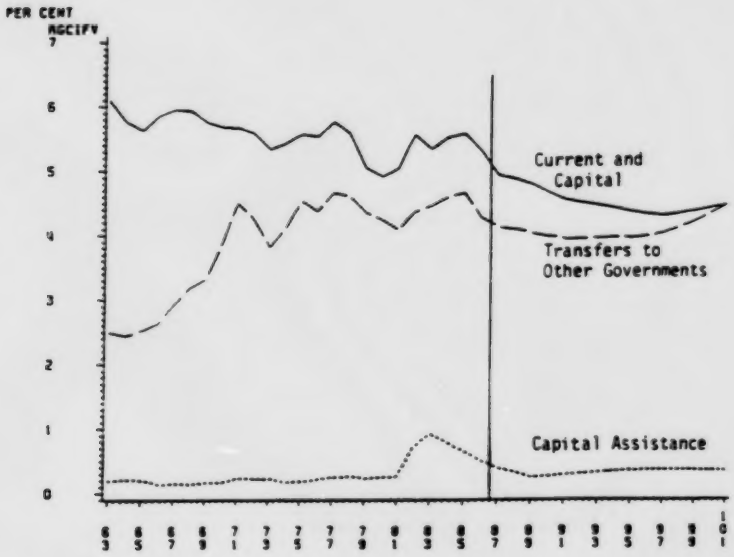


Chart 10
Federal Revenue Items: Percent of GDP

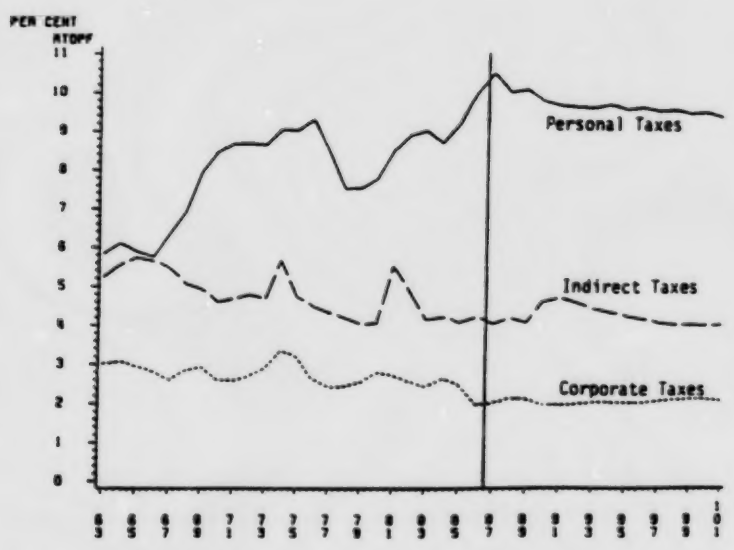


Chart 11
Federal Deficits as Percent of GDP

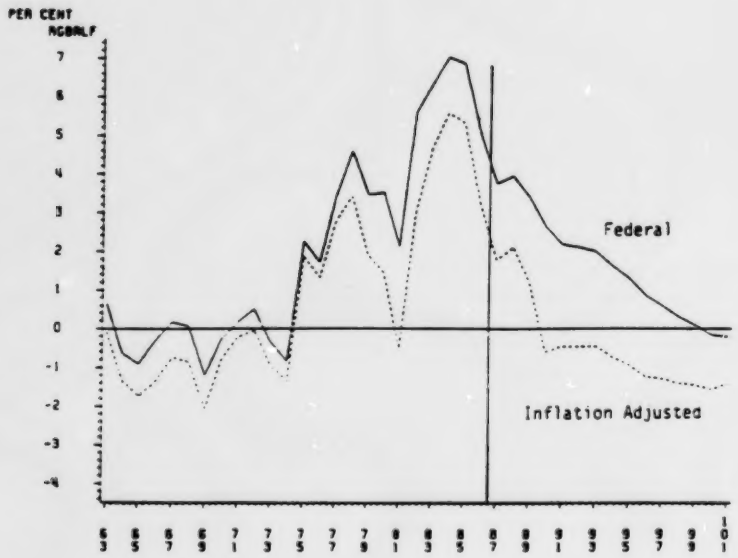


Chart 12
Corporate and Government Finance Requirements (Estimate)
(percent of GDP)

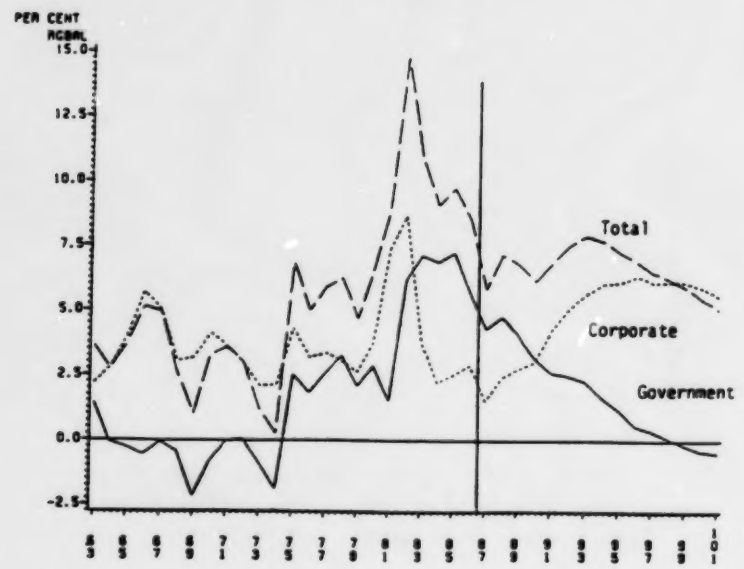


Chart 13
Federal Debt as Percent of GDP (Estimate)

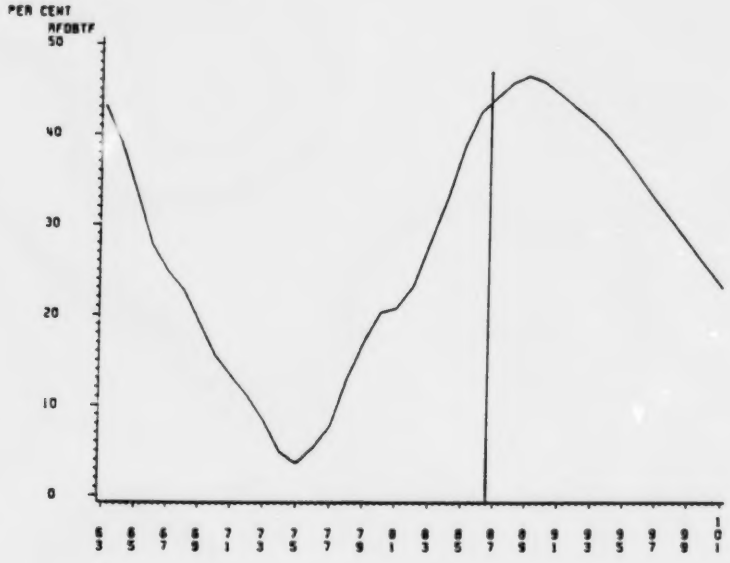


Chart 14
Phases I & II of Tax Reform: Total Fiscal Effects
(Exchange Rate Target)

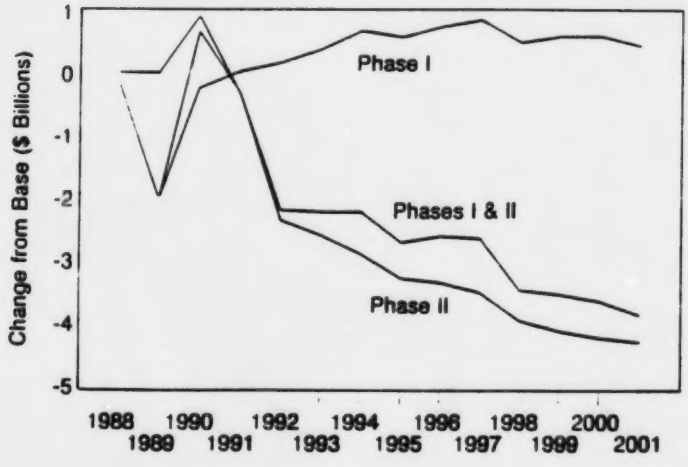


Chart 15
Phases I & II of Tax Reform: Economic Effects
(Exchange Rate Target)

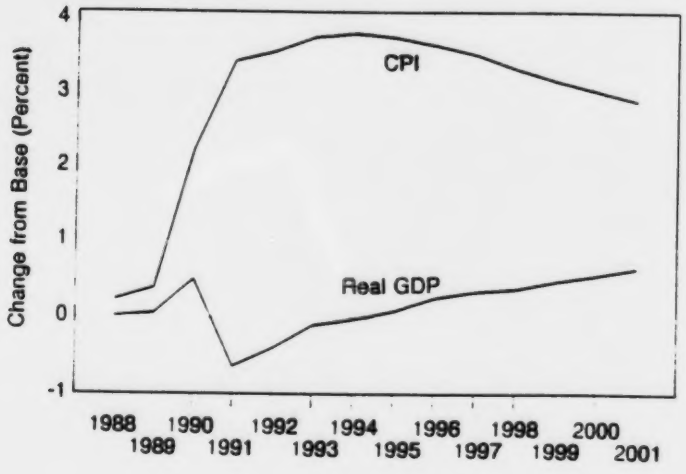


Chart 16
Phases I & II of Tax Reform: Investment
(Exchange Rate Target)

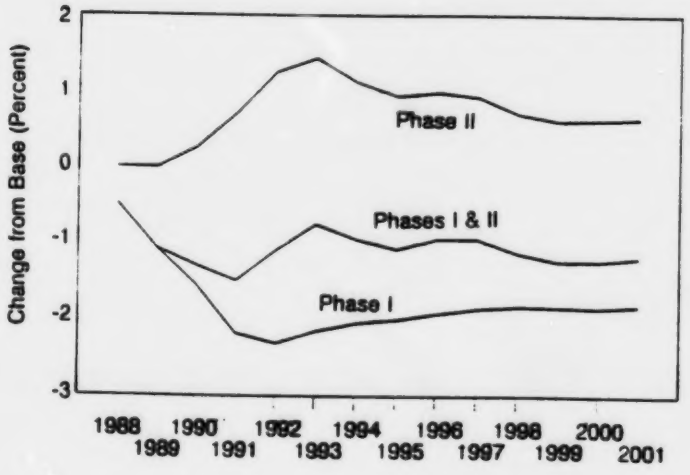


Chart 17
Free Trade
Output & Prices

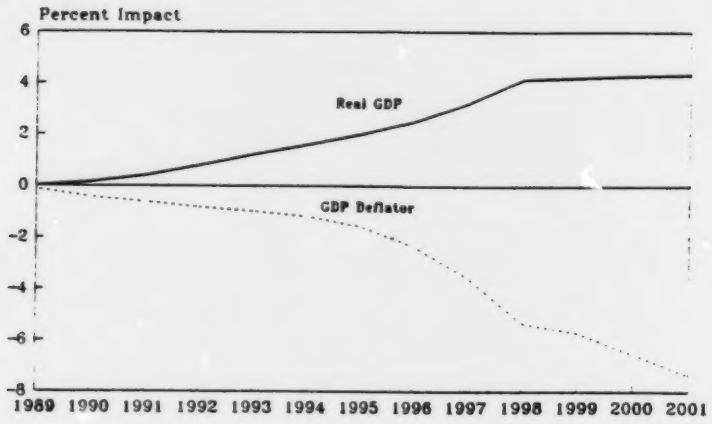


Chart 18
Free Trade
Investment & Consumption

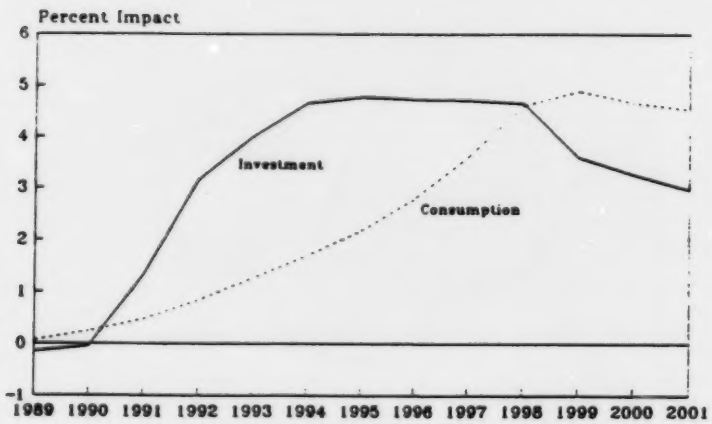


Chart 19
Free Trade
Real Exports & Imports

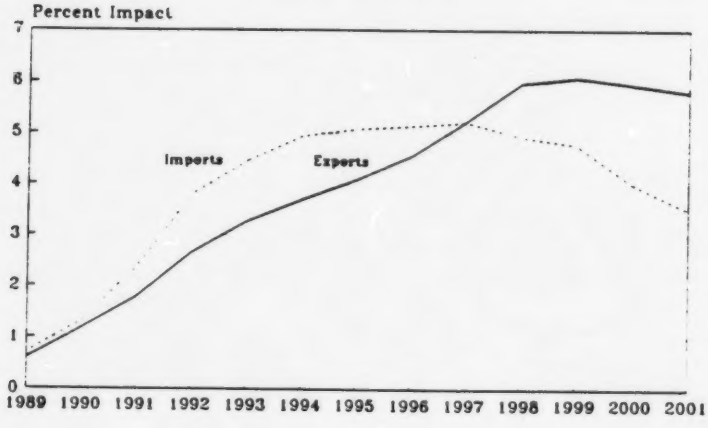


Chart 20
Free Trade
Exchange Rate & Terms of Trade

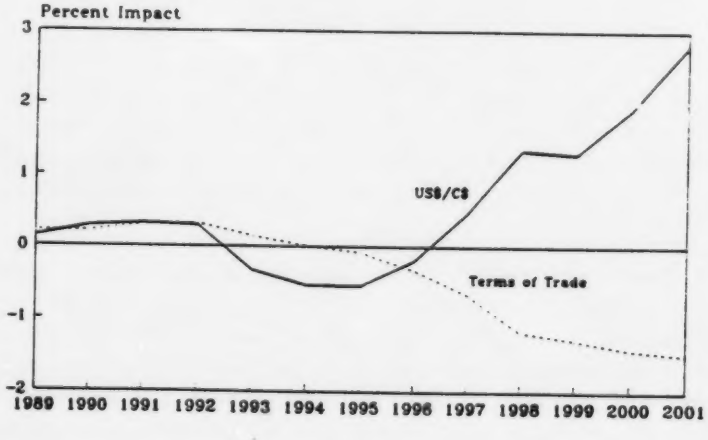
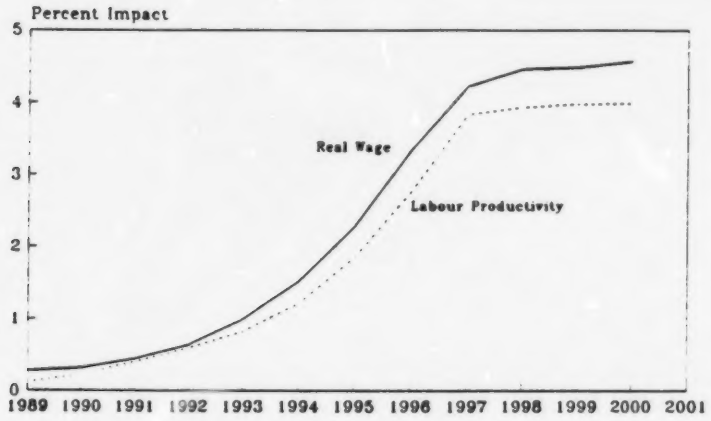


Chart 21
Free Trade
Real Wage & Labour Productivity



Comments

Yutaka Kosai

First, what does your economic forecast have to say about energy prices?

Second, when we think about the global economy, the accumulated U.S. debt of $400 billion is a major concern. If this deficit situation continues it will have a drastic impact on the U.S. economic status in the 1990s. What sort of fluctuations do you expect for the U.S. debt in the 1990s? Will it continue to accumulate?

Finally, I realized from your presentation that, although the inflation rate in Canada may come down, interest rates will not. During the 1960s and 1970s the real term interest rate was not so high, and only became so in the 1980s. What is the reason for this high interest rate in real terms and what impact does it have? Will it continue to be high throughout the 1990s?

Tom Wilson

Let me deal first with your question on energy prices. Since our economic forecast is a macro-model we don't explicitly have energy prices in it. However, I would like to tell you about the total investment adjustments we made, which include adjustments for free trade and energy investments. We forecast a peak adjustment in investment of the order of about 7 or 8 percent of GNP add-on in 1994. This increase reflects both free trade and the energy adds. Unfortunately, I don't have a breakdown, but my guess would be that, at that time, the free trade adjustment would be a little more than half. So you see, there would also be a significant energy add factor.

Let me now address the U.S. debt question. We assumed at the time that we did this forecast, right after "Black Monday", that there would be some further deprecation of the U.S. dollar relative to overseas currencies; and this did occur. Specifically, we assumed that the U.S. dollar would continue to depreciate relative to the yen and the deutchmark about in line with the inflation differentials. Now that may have been a little too cautious and insufficient for the necessary correction. I was recently at a conference where Professor Rudy Dornbush from MIT spoke and he argued very strongly that the U.S. dollar required a further real depreciation of 15-20 percent to put the U.S. economy onto a track where it would be able to service the debt burden and to have the foreign-debt-to-GNP ratio reach a peak around 1990.

As far as real interest rate differentials are concerned, although we do seem to have some narrowing, I don't believe interest rates will go back to the low levels that prevailed in the first part of the post-war period. The standard explanation for this is two-fold. First, there is the fact that we have a major industrial country, the U.S., putting a big burden on capital markets. Second, is the tremendous need for capital in the developing world. With this demand for capital and its very high real marginal productivity, I don't think that we can look forward to the kind of low real interest rates that we had in the 1950s and 1960s.

Atsushi Shimokobe

Tax cuts will be very important in the future, as will the move towards the value-added tax. What can you tell me about the distribution of the social strata by income levels in Canada. I also would like to know the definition of the corporate tax. I feel that there is some ambiguity in that definition, especially in relation to overseas investment. Do you think that the Canadian corporate tax rate is a hindrance in terms of corporate investment?

Tom Wilson

Income tax cuts are concentrated on two groups. One group is low-income people, a number of whom are being removed from the tax rolls. (This is a favorite phrase of Canadian Ministers of Finance. They remove people from the tax rolls but mysteriously the tax rolls increase.) Nevertheless, I think that there are some significant reductions in store for the lowest-income people. There will also be improvements in the tax position of a lower-income spouse. An individual, working part-time and maintaining a home, currently faces an effective tax rate at the higher-income spouse's marginal rate. Under the new system, those persons will have a separate rate schedule and should have a lower rate. The other group that will benefit will be high-income people whose income is mainly from salaries. These are the people who do not take advantage of shelters and favoured sources of income. There will be some very big winners here. For example, a senior civil servant making a salary of over a $100,000 a year, with no other income, will get a big benefit. On average, however, a lot of high-income people will pay more tax because of the increased effective rate of tax on capital gains and the elimination of shelters, as well as a general tightening of the tax system.

The shift to a value-added tax is probably not going to hit low-income people hard. Indeed, I have the feeling that unless the government is very careful, it is going to give an overdose of benefits to low-income people. The proposal is that low income people will receive tax credits to offset their increased sales tax burden. But one must also consider the fact that the poor receive a lot of transfer payments that are indexed, so they will probably be better off under a VAT system. The people I think will suffer from the shift to sales tax will be the lower, middle-income classes. Like the lower-class, the upper-income and upper middle-income classes will probably benefit.

The corporate tax changes are difficult to discuss without getting into detail. I do know that the concern in Ottawa is to bring our statutory rates in line with those in the U.S. In the manufacturing sector, where we have a favoured rate, I believe the statutory federal rate will be dropping to about 23 percent. Even if you add 10 percent for the provinces, we are still quite competitive with the Americans. The worry is that, if our rates remained too high, there would be a big incentive—not so much for industry to relocate but for accountants to relocate the profits. It is much easier to move the profits around through accounting than to actually move the activities.

Noriyuki Takayama

Tax reform is currently under way in Japan, and discussion has focused on cutting private income taxes, with the emphasis on the implications for consumption. It has also been proposed that the inheritance and capital gains taxes be increased. The tax revenue structure in Japan can be characterized has having too much emphasis on corporate income tax. How would you characterize the Canadian tax revenue structure? You say that there will be a cut in the private income tax, but if you place emphasis on consumption, what will be the balance between consumption and income in terms of taxation revenue?

Second, in phase two of tax reform, you say that you are going to introduce a value-added tax. When you introduce this indirect tax, what will be exempted and what will be given a zero rate? You have mentioned residential rents will be exempt. Why is this item so important in Canada?

Finally, thinking about economic growth, will tax reform improve or promote investment? And what about savings taxes?

Tom Wilson

First I would like to respond to your question about the balance of tax on income and consumption. At the moment our federal manufacturer's sales tax is the second most important source of revenue to the federal government. It is surpassed by the personal income tax, but it is more important than our corporate income tax or corporate profit tax. What the reform will do is change the nature of that tax in two important ways. One, it will become broader (right now it is on a very narrow base of goods) and there will be efficiency gains as a result. In addition, the government will remove the tax on business inputs and investment. Currently, although many investment goods are exempt, a lot of goods that have mixed use, such as personal computers, office furniture, and automobiles for business purposes, still bear that tax. Motor fuels also bear a big tax. So the tax does bear on investment goods and business inputs. Roughly 40-50 percent of the weight of the tax is in this area. Reform will increase the burden on consumption and reduce it on investment and exports, which will be good from a resource allocation standpoint.

In addition, the proposal is to raise more revenues from this tax for three purposes. One is to reduce our middle-bracket rate in the new income tax structure. We are going to have three rate brackets and currently there is a big jump from the first to the second bracket and I think the government wants to put the second bracket about halfway between the low bracket and the top bracket. Second, they want to eliminate the surtaxes we now have on both corporate income and personal income tax. Finally, revenue is required to pay for low-income tax sales tax credits.

Canada, like Japan is also tightening up on capital gains. One of the first acts of the new government was to create a phased-in $500,000 lifetime exemption. However, it has now stopped this exemption at $100,000 and in the future, our inclusion rate for

capital gains will be 75 percent instead of 50 percent. Unlike Japan however, Canada has no federal inheritance tax.

Your second question dealt with what will be exempt and what will not be exempt in the VAT. The government originally proposed a comprehensive VAT, arguing that the sales tax credits could handle the problem of regressivity. But, even in that proposal, they did not propose to tax residential rents. I think that the reason is that there is no way you can tax imputed rents. We don't tax imputed rents of owner-occupied houses under the income tax and the political opposition if the government proposed taxing it under the sales tax can be predicted. So the proposal is to treat residential rents neutrally. Although the rents won't be taxed, the buildings will be. When you build a residential unit, whether it is an apartment house to be rented or an owner-occupied dwelling, it will bear the new VAT. In December 1987, the minister backed off from the general comprehensive nature of the VAT and said that food and drugs will be exempt. I assume that that means they will be zero-rated.

Regarding investment and savings, Phase I of tax reform is negative on investment. I might add that there was even a preceding phase where we eliminated our investment credit and lowered corporate rates. That preceding phase also had a negative effect on investment. So, the Phase I package doesn't look very favourable from a macro-standpoint. Offsetting that are the resource efficiency gains for taxing different assets in different industries more equally. Those can be important. John Whalley's research into this indicates that the negative macro effects are just about offset by the improved resource allocation effects.

On savings, I don't think that the points I have discussed here will have much impact. The government has, however, put into place a much more generous treatment of retirement savings. So over the medium term there might be a plus for savings and we forecast that the inflation adjusted savings rate, after a bit of oscillation, will gradually rise. You should note that the personal savings rate in Canada is historically higher than that of the U.S., and we expect this to continue, which is a good thing, because, since we have so much investment need, we are going to have to rely on foreign borrowing.

Canada–Japan Economic Relations: Bilateral, Trilateral and Multilateral Dimensions

Murray G. Smith
Institute for Research on Public Policy

The present Canada-Japan economic relationship is characterized by a vertical trade structure. Canada exports resource products to Japan while Japan exports manufactured products to Canada. The future evolution of Canada-Japan trade and investment links will be influenced by the changing trading environment including the proposed implementation of the Canada-U.S. Free Trade Agreement and the outcome of the Uruguay Round of multilateral negotiations, as well as macroeconomic factors influencing multilateral exchange rates and current account flows.

This paper covers three aspects of Canada-Japan economic relations. The first section reviews Canada-Japan bilateral trade and seeks to identify some of the key factors which may influence the bilateral relationship. The second section examines the implications of the Canada-U.S. Free Trade Agreement for bilateral trade and investment for Canada and Japan in the context of the relationship of both countries with the United States, as well as considering the broader repercussions for the multilateral system. Finally, the concluding section comments on how the policy environment, both in North America and in Japan, will be influenced by the swings in international asset positions in the 1980s, and ensuing current account adjustments in the 1990s, which may affect the prospects for the Uruguay Round of multilateral negotiations, as well as the bilateral relationship between Japan and Canada.

Canada-Japan Bilateral Trade

The vertical structure of Canada-Japan trade is evident from Table 1, which summarizes Canada's exports to Japan. We see that food products, crude materials and fabricated materials account for about 90 percent of Canada's exports to Japan. In those product categories, the exports to Japan account for a disproportionate share of Canada's total exports of those products. The reverse is true for end products, where over 90 percent of Canada's exports go to the United States. Table 2 looks at the composition of Canadian imports from Japan and we observe that the reverse structure of trade occurs. Almost 90 percent of Japan's exports to Canada are end products, with automobiles being a very important component.

In Chart 1 we see the pattern of bilateral Canada-Japan trade in exports, imports and the balance of trade in nominal terms, as measured in thousands of Canadian dollars. It shows that Canada, for a long period, ran a trade surplus with Japan. That surplus turned into a deficit in 1984-85, but started to contract in 1987. Chart 2 examines the bilateral trade balance in real terms, in 1971 Canadian dollars. Thus, with 1971 relative prices, Canada would not have run a trade deficit with Japan in the 1980s. What happened is that with the weak prices for Canadian commodity exports (which we can see in Chart 3), Canada's export prices to Japan fell while the import prices from Japan continued to rise. This resulted in a marked deterioration in Canada's bilateral terms of trade with Japan. There are perhaps two phenomenon working here. One is a bilateral j-curve. Apparently the realignment of the Canadian dollar versus the yen since 1985 has influenced our bilateral terms of trade. It is also true, at least on the export side for Canada, that the weakness of global commodity prices in the mid-1980s has had an adverse effect on the nominal value of Canadian exports to Japan.

Chart 4, which looks at the bilateral current account, shows the changes since 1985 through 1987. Examining the composition of the current account in 1987, we see that there was a deficit on nominal merchandise trade in Canada's trade with Japan and a surplus in trade in services which no doubt reflects the increasing number of Japanese tourists coming to Canada. However, there is a remarkable phenomenon in the investment income account, where there has been a very large growth in investment payments (interest and dividends) to Japan by Canada since 1985. Clearly Japanese investors have been acquiring some of the Canadian debt which has been growing very rapidly in the 1980s. So far this has only shown up in the current account, and not as yet in a pronounced way in the trade of goods and services.

The Canada-U.S. Free Trade Agreement

Turning to a review of the Canada-U.S. Free Trade Agreement, two new factors can be discerned. First, the buildup of Canadian liabilities to Japan suggests that Canada will need to restore and expand its bilateral surplus on trade in goods and services. Second, the growth of Japanese direct investment could facilitate the emergence of a more horizontal trade structure. The issue of free trade provokes diverse views amongst

Canadians. Perhaps the best metaphor that I can offer is the classic Kurasawa movie, "The Rashoman Gate", in which there is a crime committed in the forest and everyone who sees the crime has a different perspective on the event. The Institute has published a book entitled, *Assessing the Canada-U.S. Free Trade Agreement*, that reflects a diversity of Canadian views. In this paper, I present my own perspectives and will not attempt to reflect the diversity of Canadian views.

There is an interesting philosophical question that we need to consider. To varying degrees the GATT frowns on bilateral, managed, sectoral trade arrangements, such as the U.S./Japan semi-conductor arrangement, or indeed, the Canada/U.S. AutoPact. But Article XXIV of the GATT welcomes free trade areas and customs unions. One might wonder whether this reflected some form of schizophrenia on the part of the drafters of the GATT. Sir James Meade, the eminent British economist, and Clair Wilcox, the chief U.S. negotiator, considered this question when they helped to develop the GATT in the 1940s.[1] There is a very compelling argument that if you go the route of removing all barriers in the customs-union or free-trade area while not raising barriers against trade with third countries, then the agreement is much more likely to be trade-creating than if you follow the partial, sectoral and managed-trade approach. The one caveat, of course, is that a free-trade agreement under Article XXIV of the GATT, removes all barriers, except for some agricultural trade barriers.

The Canada-U.S. Free Trade Agreement is clearly shaped by the pressures upon, and many of the distinct features of, the bilateral relationship between Canada and the United States. However, the Canada-U.S. Agreement is a classic free trade area, broadly compatible with Article XXIV of the GATT. If the Agreement is implemented, by 1998 all tariffs and many quantitative restrictions will be eliminated from Canada-U.S. trade, and it goes somewhat further in dealing with investment or services issues than previous free trade agreements.

Is the Canada-U.S. Free Trade Agreement trade-creating or trade-diverting, both in the global sense and in terms of the bilateral trading relationship with Japan? My answer is yes. The Canada-U.S. Free Trade Agreement appears to be trade-creating on a global basis, because trade barriers are not increased against third countries and because there is evidence of economies of scale in the expansion of intra-industry trade between the two partners. Furthermore, the Canada-U.S. Free Trade Agreement does not raise trade barriers against third countries.

The precise answer for Japan depends very much on your assessment of the implications of the provisions in the automotive sector. Paul Wonnacott, in our recent publication on the Canada-U.S. Free Trade Agreement, argues very persuasively that the existing automotive arrangements between Canada and the U.S. are on an unstable and unsustainable course.[2] He maintains that Canada's duty-remission policies, which have been made available to Japanese firms, would have almost certainly led to a countervailing duty case and the potential closure of the U.S. market to Canadian firms. In particular, operations in Canada of Japanese automotive firms are the most appealing targets for some of the protectionist automotive interests in the United States. Wonnacott argues quite forcefully that the automotive provisions of the Canada-U.S. Free Trade Agreement balance Canadian and U.S. interests very well and deflect U.S.

protectionist pressures. In particular, the automotive provisions prevent the possibility of a countervailing duty case and avoid a very serious problem between Canada and the United States and also for Japan in its relations with both countries.

While it is true that there is one anomaly about the automotive provisions of the Canada-U.S. Free Trade Agreement, broadly speaking, the rules of origin in the Agreement are the conventional rules of origin in free trade areas, and the rules of origin for automotive trade reflect the general rules of origin for assembly of other products. The anomaly is, however, that the current automotive companies producing in Canada (principally the big three North American firms which qualify as AutoPact suppliers) retain forever the right to import duty-free either components or finished vehicles from third countries. This does give them a permanent advantage in the Canadian marketplace over those companies that do not have this right. Now Japan's interests in this case are mixed. The large Japanese automotive companies do not qualify, but companies like Suzuki and Mitsubishi, which have captive arrangement with the big three North American automotive producers, do. Aside from that anomaly, the Agreement is very positive for the automotive sector in terms of Japanese concerns and interests and will increase further bilateral trade between Canada and Japan, as well as fostering increased triangular trade among the United States, Japan and Canada in this sector. I would argue that the Canada-U.S. Free Trade Agreement improves prospects for the horizontal division of labour between Canada and Japan through increased Japanese investment, particularly in the automotive sector, and through increased intra-industry trade in the machinery, equipment, auto parts and various components that are related to that automotive investment.

I also argue strongly, in *Bilateralism, Multilateralism and Canada in U.S. Trade Policy* for the Council on Foreign Relations, that the Canada-U.S. Free Trade Agreement will create a positive trade dynamic. The important question about a free trade agreement is not only whether it is trade-creating or trade-diverting at the time the agreement is concluded, but how the partners to that agreement will behave in subsequent bilateral and multilateral negotiations. My argument is that in a free trade area the essential feature is that each of the partners retains its own commercial policies for dealing with third countries. Thus, the partners are much more likely to have an outward looking approach in subsequent negotiations with third countries than would be the case in a customs union such as the European Community.

Thus, in the Uruguay Round, Canada will be negotiating on items such as tariffs on machinery and equipment and on automotive products. Japanese companies will be the principal suppliers of those particular products in many cases and the bilateral negotiation in the GATT will be between Canada and Japan. I believe that Canada will be prepared to negotiate very constructively on those issues because many of those components are inputs into the production processes of Canadian firms and those firms will now wish to become more competitive with their North American competitors and U.S. counterparts. They will want to see Canadian tariffs on imports reduced. If Japan is prepared to negotiate constructively to reduce trade barriers impeding the export of agricultural and processed resource products, as well as selected manufacturing products where Canada has developed a technological capability, then Canada can be expected to offer reciprocal tariff reductions on Japanese exports. Thus, multilateral negotiations in

the Uruguay Round could reduce the preferences created by the phased elimination of trade barriers between Canada and the United States.

Balance of Payments Adjustment and the Policy Environment

This final section considers how adjustments in the balance of payments and related exchange rate developments can be anticipated to influence the political economy of trade and investment among the major industrial countries.

Taking a retrospective view, in 1985, I co-authored a study that argued that the U.S. dollar was overvalued and that the growing indebtedness of the U.S. economy in the 1980s would compel a sustained and prolonged real devaluation of the U.S. dollar—and an equivalent appreciation in the yen.[3] Needless to say, that view was not well received by American audiences. Donald Regan was the Secretary of the Treasury in the United States, and the official view was that the Reagan Revolution in the United States had unleashed a new spirit of capitalism in the United States and that the strong U.S. dollar reflected a burgeoning of the capitalist spirit.

Unfortunately, the mood of U.S. trade policy was becoming very defensive. At that time we anticipated the evolution of U.S. protectionist pressures in the last several years as a response to that strong and overvalued U.S. dollar. In particular, we were concerned that the slow adjustment of the U.S. trade account, which was to be expected, would lead to protectionist trade legislation in the United States even after the exchange-rate situation had begun to turn around.

Although protectionist pressures did become intense in the United States, I have now some reason to believe that my forecast will be proved wrong. The effects of both Black Monday, the October stock market crash, and Super Tuesday, where Congressman's Gephart's presidential campaign failed, have blunted protectionism in the U.S. Congress more than I anticipated. Thus, there is reason to believe that we have turned the corner in terms of U.S. protectionism, although we will not know for certain until we have assessed the final outcome of the U.S. trade legislation in the 100th Congress.

Looking ahead, we might consider how balance of payments adjustments might unfold and how the associated pressures on exchange rates and trade flows might influence the policy climate. Although exchange rates among the currencies of the major industrial countries prevailing in early 1987 may be appropriate in light of current savings-investment imbalances, the present current account imbalances are unsustainable in the medium term. As Rudiger Dornbush and Paul Krugman have argued, the accumulation of foreign liabilities by the United States (and also Canada) in the 1980s will require further realignment in real exchange rates in the 1990s. Japan as a large net creditor will experience yen appreciation and internationalization of the

economy, while Canada and the United States will need to earn trade surpluses in offshore markets.

Conclusion

Focusing on the bilateral dimension, in the 1990s Canada will run trade surpluses with Japan. The magnitude of those trade surpluses will depend on what happens to world commodity prices. However, given the build-up of Canada's external indebtedness to Japan, Canada will be obliged to service those international liabilities and, thus, will need a corresponding surplus in merchandise trade and trade in services. Perhaps there will be a boom in Japanese tourists coming to Canada as well as a swing toward a surplus in merchandise trade.

In terms of the stance of Canada and the United States in the multilateral negotiations, there are reasons to be optimistic. As debtor nations, the United States and Canada will be obliged to run trade surpluses with the rest of the world in the 1990s. The realignment of trade patterns may facilitate efforts to roll back, on a bilateral basis, some of the protectionist provisions in each country's trade laws. At the same time, each country's national interests will impel it to offer negotiated reductions in trade barriers to third countries during the Uruguay Round.

One might be less optimistic about the stance third countries might adopt in the Uruguay Round. The European Community is a source of particular concern to me, both with respect to traditional tariff and non-tariff barriers and also with respect to agricultural trade. I do worry greatly about how much we will be able to achieve in the Uruguay Round, particularly on agricultural trade. And that is an important issue that will have to be addressed at the mid-term review in Montreal.

Depending on the amount of progress in the Uruguay Round, Japan and other Pacific countries may have an interest in pursuing a larger free trade area involving Canada and the U.S. after the end of the Uruguay Round. Japan might find it of particular interest to pursue the idea of free trade in industrial products that happens to leave aside some of the more difficult agricultural issues.

Whatever transpires in future trade negotiations, I would suggest we are entering into a more interesting period in Canada/Japan relations. Perhaps, as Professor Iwasaki noted yesterday, a more interesting period of bilateral relations and one of closer interaction may have some associated frictions but there is reason to believe we can resolve them in cooperative fashion.

The proposed implementation of the Canada-U.S. Free Trade Agreement could reinforce the recent trend for Japanese direct investment in Canada in the automotive industry and facilitate a shift toward a more horizontal trade structure involving a greater proportion of intra-industry trade.

Notes

1. Andreas Lowenfeld quotes in William Diebold (ed.) ***Bilateralism, Multilateralism and Canada in U.S. Trade Policy***, quotes from Clair Wilcox (Cambridge, Mass.: Ballinger for Council on Foreign Relations, 1988) on this question.

2. Paul Wonnacott, "The Automotive Sector" in Jeffrey Schott and Murray G. Smith (eds.), ***The Canada-United States Free Trade Agreement: The Global Impact*** (Washington, D.C.: Institute for International Economics and Halifax: Institute for Research on Public Policy, 1988).

3. Richard G. Lipsey and Murray G. Smith, ***Taking the Initiative: Canada's Trade Options in a Turbulent World*** (Toronto: C.D. Howe Institute, 1985).

Table 1
Summary Comparison of Value and Percent Share of Total Domestic Exports To Japan

	1970		1980		1987	
	Share	$000	Share	$000	Share	$000
Total	***4.94%***	***810,142***	***5.85%***	***4,356,518***	***5.78%***	***7,017,446***
Live animals	1.50%	1,025	2.51%	6,374	0.45%	1,642
Food, feed, beverages and tobacco	7.25%	130,582	9.56%	765,559	11.65%	1,191,842
Crude materials, inedible	13.23%	406,032	13.17%	1,943,072	16.74%	2,812,404
Fabricated materials, inedible	4.29%	251,924	5.23%	1,535,621	6.39%	2,668,776
End products, inedible	0.37%	20,471	0.48%	105,747	0.66%	342,656
Special transactions trade	0.35%	109	0.06%	145	0.04%	125

Table 2
Summary Comparison of Value and Percent Share of Total Imports From Japan To Canada

	1970		1980		1987	
	Share	$000	Share	$000	Share	$000
Total	***4.17%***	***581,715***	***4.04%***	***2,795,844***	***6.49%***	***7,551,616***
Live animals	0.04%	13	0.02%	17	0.02%	34
Food, feed, beverages and tobacco	1.64%	17,797	1.04%	48,667	1.13%	74,653
Crude materials, inedible	0.10%	1,164	0.38%	42,547	0.31%	22,827
Fabricated materials, inedible	5.88%	169,553	3.81%	484,600	3.05%	635,404
End products, inedible	4.51%	388,496	5.54%	2,196,642	8.52%	6,760,910
Special transactions trade	2.91%	4,694	3.07%	23,371	2.86%	57,789

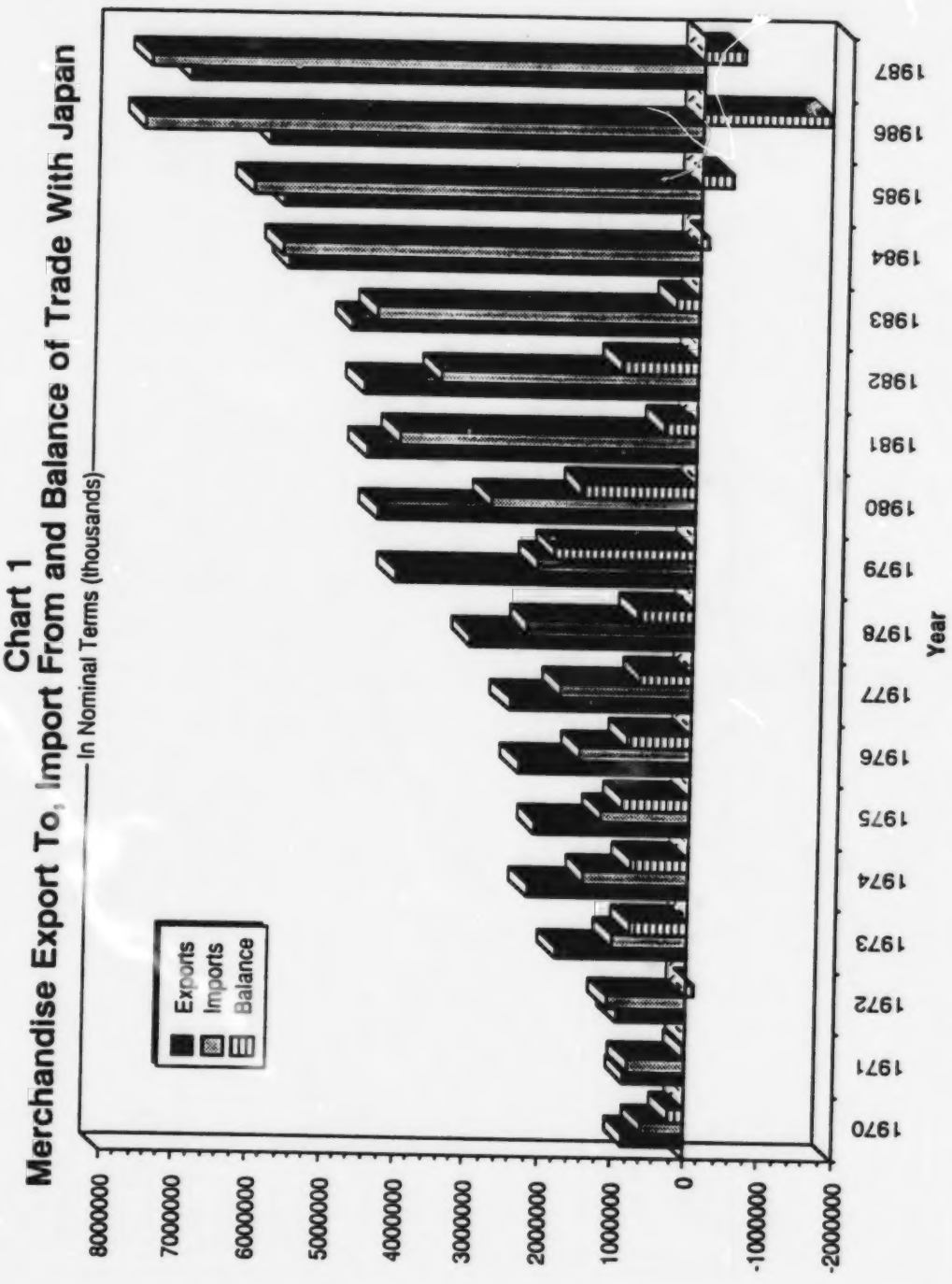
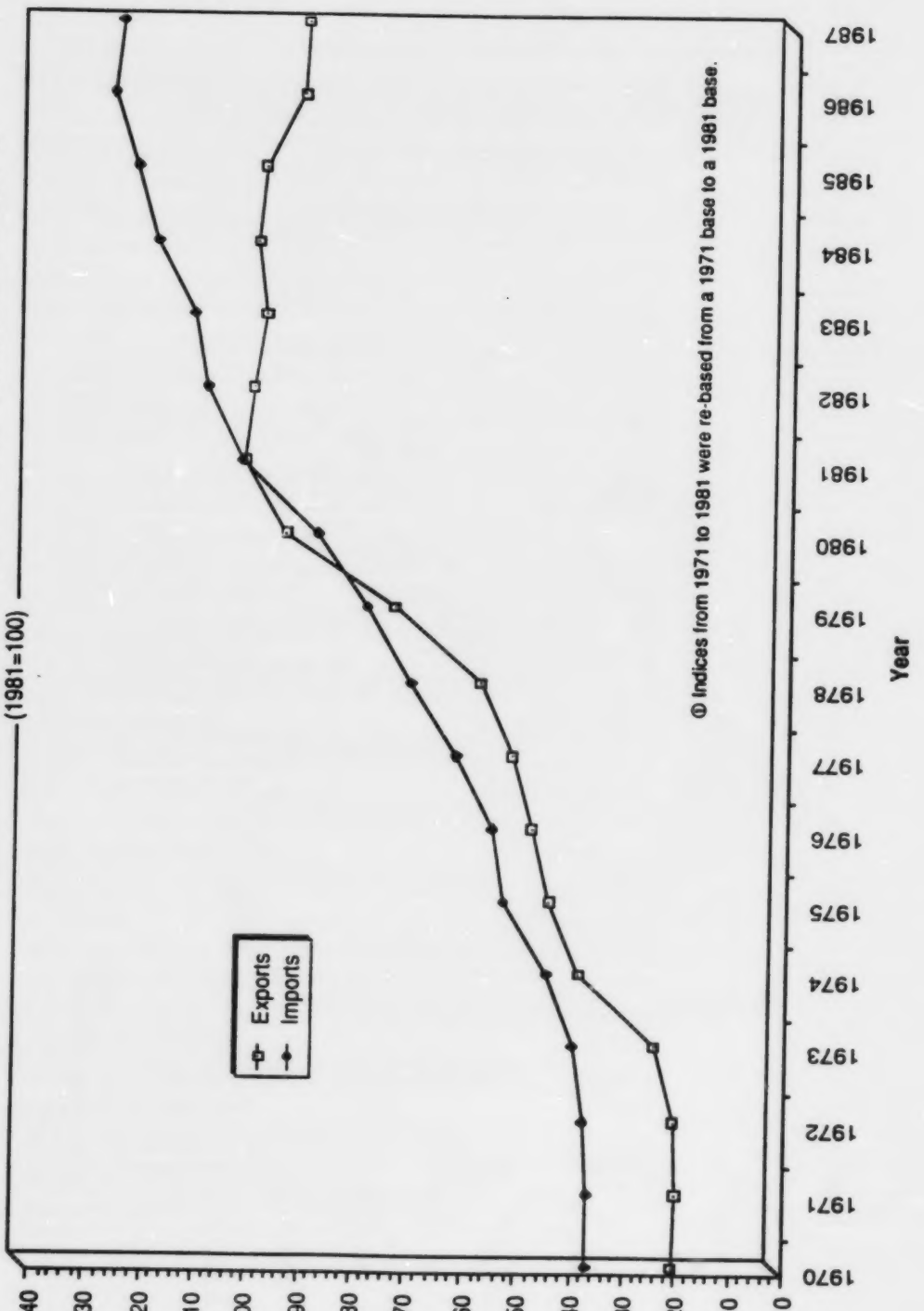


Chart 1
Merchandise Export To, Import From and Balance of Trade With Japan
In Nominal Terms (thousands)
Exports
Imports
Balance
8000000
7000000
6000000
5000000
4000000
3000000
2000000
1000000
0
-1000000
-2000000
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
Year

Chart 2
Merchandise Export To, Import From and Balance of Trade With Japan
In Real Terms (thousands)
Exports
Imports
Balance
80000
70000
60000
50000
40000
30000
20000
10000
0
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
Year

Chart 3
Price Indices of Bilateral Exports, Imports and Terms of Trade ①



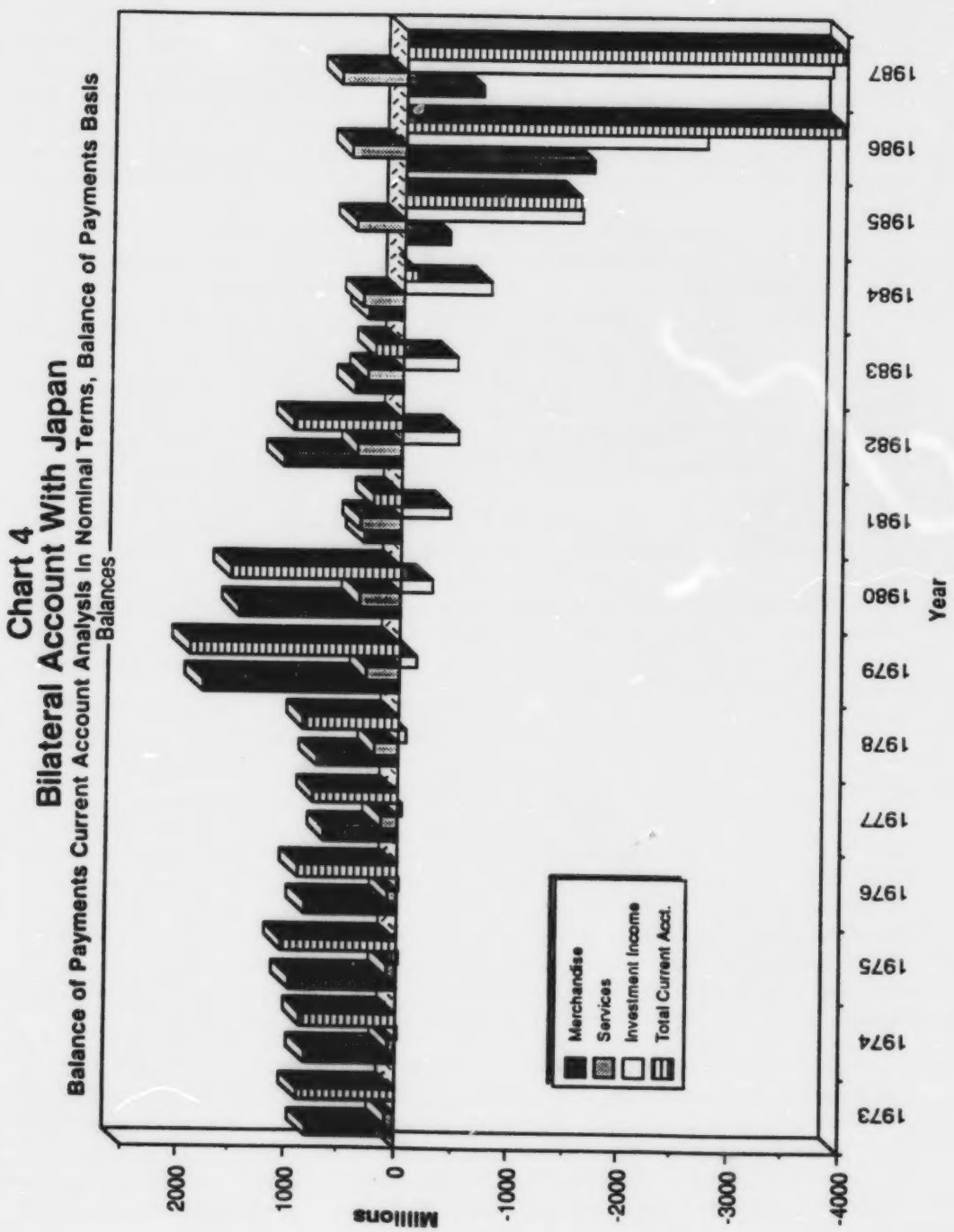


Chart 4
Bilateral Account With Japan
Balance of Payments Current Account Analysis In Nominal Terms, Balance of Payments Basis
Balances
Millions
2000
1000
0
-1000
-2000
-3000
-4000
Merchandise
Services
Investment Income
Total Current Acct.
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
Year

Comments

Toru Yano

There are two basic points I would like to comment on. The first is about U.S. protectionism. We in Japan think that the United States has weaknesses which will make it impossible for protectionism to continue and I would like to know if you concur with this impression. The second question deals with the interest to be shown by third countries in the Canada-U.S. Free Trade Agreement. Suppose that Japan is included in the Free Trade Agreement, do you think that this would be an acceptable position for Canada?

Murray Smith

I would like to deal with your question regarding the protectionist mood in the United States first. I believe that the intensity of the protectionism mood in the U.S. began to wane late last year. Congress tends to lag behind the broader political sentiment because congressmen, and the staffers of the key congressmen, have invested a great deal of their time and political prestige in drafting these protectionist provisions. One of my concerns has been that the sheer inertia of these protectionist provisions will move through the legislative system even though the protectionist sentiment in the U.S. heartland, that is the industrial manufacturing areas in the U.S. mid-west, no longer has the same intensity that it had. In particular, there has been a shift in the attitudes of the resource sectors of the United States, where Canada has experienced so much difficulty in recent years. The improvement of commodity prices, as measured in American and Canadian dollars, has meant that the U.S. forest industry, parts of its agricultural sector, the mining industry, and even elements of the energy sector, are no longer under the intense pressures that they were two or three years ago.

The other reason why American protectionism may be averted is an argument that I have pushed very hard with audiences in the United States. In the 1990s, when the United States is obliged to service its large external debt, the idea of unilateral measures under its trade laws against imports are no longer going to have the same appeal, they are no longer going to have the same effectiveness in terms of meeting the interests of United States constituents. You are going to have many more industries that have an interest in getting access to export markets. These industries are going to be more interested in getting an effective set of trading rules in the General Agreement on Tariffs and Trade. I think a few people in the United States, such as Senator Benson or others in the elite trade policy community, are receptive to that argument. Certainly Fred Bergsten of the Institute for International Economics has argued that case very strenuously.

Regarding the interest of third countries in the Free Trade Agreement. I think that this is a very interesting and serious question, but I don't think that it will be addressed until after the Uruguay Round is completed and we see changes emerge in the realm of tariff and non-tariff barriers and many other issues. I hope that it is possible to achieve a very positive outcome from the Uruguay Round in terms of trade liberalization. If that is the case, the issue of third country participation in the Free Trade Agreement

will become a much less important issue. As Gary Huffbaeur has argued, it is possible that we might ultimately move through the GATT to a Free Trade Agreement among the industrial countries within the next 20-30 years. But there are serious questions hanging over the Uruguay Round. Will it be possible to resolve differences over agricultural trade? Will the European Community be cooperative or will its efforts be primarily focused on the impending internal consolidation? How will developing countries participate in the proposed agreements? If we do not achieve a positive outcome from the Uruguay Round, or if the prospects of a positive outcome appear unlikely, then it may be of interest to Japan, its Asian neighbours, Canada and the United States to explore possibilities for free trade agreements involving Pacific countries.

Now, I would not underestimate the difficulty of exactly how we might organize such an arrangement. There are a range of options. For example, just Japan might have a bilateral free trade agreement with either or both Canada and the United States. Or, the two countries could mutually negotiate Japan's accession to the Canada/U.S. Free Trade Agreement. There are also other countries to consider: Australia, New Zealand, Korea and some of the ASEAN countries. It would be a major step to contemplate, and we would have to explore all of these potential options very carefully. Exploring free trade arrangements among Pacific countries might be a strategic response to be considered if the European Community becomes inward-looking in efforts to complete the internal market by 1992 and if progress is limited in the Uruguay Round. Nonetheless, Canada and Japan have an overriding interest in the multilateral trading system.

Junnosuke Kishida

Table 3 shows, that for several years, Japan has been in a surplus position in its trade relations with Canada. But in the past the trade balance has been in Canada's favour. What about the future? What are the prospects for surpluses and deficits between the two countries?

A related comment is that, as Professor Iwasaki said yesterday, Japan/Canada relationship is symmetric while both of our relations with the United States are asymmetric. But probably we should question whether the Canada/Japan relationship is really symmetric. What I am trying to get at is that, in order to be really symmetric in bilateral relations, we may need a horizontal division of labour in trade structure, otherwise it's very difficult to achieve really symmetric relationship. If we are just complementing or supplementing each other, with one country exporting primary products and the other country exporting finished products, we will not be in a truly symmetric relationship. Professor Smith used the word friction and it seems to me that we should not fear a move to a closer relationship symbolized by frictions and in which we both produce similar kinds of products. Probably, I can be considered cynical for proposing such a symmetrical and friction-producing relationship. Do you have any comment?

Murray Smith

The comment is apt. I suggest that we will evolve towards a more symmetric relationship between Japan and Canada, in the sense that the composition of our trade will shift towards a more horizontal division of labour. I expect that Canada will always be a substantial exporter of primary products to Japan and perhaps agricultural products as well, depending on how those negotiations go in the Uruguay Round. But I can see the opportunity for some evolution. There will be more two-way trade between Japan and Canada within the industrial sector, particularly in areas such as autoparts, machinery and equipment, and in some high-technology trade areas. In that sense, moving toward a more horizontal division of labour and a more symmetric trading relationship would tend to ease frictions in Canada-Japan relations.

My concern about the potential source of frictions in relations between Japan and Canada could arise from the evolution of the overall bilateral trade balance. In the 1990s, Canada is going to have to earn more of its trade surplus from countries other than the United States. Canada must have a trade surplus of about 3-4 percent of GDP just to service our foreign indebtedness. (Canada's external liabilities are about 40 percent of our GDP.) Now, Japan and Europe, as the surplus economies of the world today, are the most immediate markets for Canada to earn a trade surplus. We saw in Table 6 how Canada's interest and dividend payments to Japan have been mushrooming in recent years. I would expect that, as a result of Canadian debt service to Japan, combined with the kinds of exchange rate realignments that Rudiger Dornbush and others anticipate, Canada will have even larger trade surplus with Japan in the 1990s than we had in the 1960s or 1970s. I hope that Japan, as a creditor country, will be patient and understand that trade surpluses in bilateral trading relationships, such as with Canada, are to be expected and that this will not create frictions in our bilateral relationship. I do expect, however, that the area of agricultural trade will be a particularly difficult one between Canada and Japan.

Yutaka Kosai

I have two observations. The first is about the Free Trade Agreement and protectionism, which was partly explored by Dr. Yano's question. The second has to do with the outlook for exchange rates.

First, about protectionism. I would agree with Mr. Smith when he said that the exchange rate adjustment or dollar devaluation has turned the corner. The overvalued dollar has come to its limit. The U.S. unemployment rate is less than 6 percent, so the macroeconomic reasons for turning to protectionism are waning. Protectionists in the United States are fighting the war of the past not the war of tomorrow. However, this doesn't necessarily mean that the United States is moving towards free trade, especially *vis-à-vis* Japan. Some 30 percent of industrial products, such as steel, textiles, automobiles, motorcycles and machine tools, exported from Japan to United States, are subject to some form of tariff or non-tariff regulation or barriers. So, just like the agricultural sector in Japan, the American industrial sector is being protected. Unless

this is stopped, there can be no free trade between the U.S. and Japan. If Japan is to open or liberalize agriculture, the United States should be equally determined to open industrial products or their industry markets should be open. Otherwise a free trade agreement would rather prohibit Japanese investment. If Japan were included in the existing Canada/U.S. Free Trade Agreement while the barriers on the industrial products remain, it would restrict Japanese investment, either to Canada or the United States.

As to the second point, just like Mr. Smith and other scholars, I think that the yen will appreciate further, while the dollar will be further devalued. For your information, this opinion is a minority opinion in Japan. Most Japanese economists are satisfied with the present rate of exchange between the Japanese yen and the American dollar. They feel that the PPP (purchasing power parity) indicates that the Japanese yen is strong enough and that Japan has done a lot of overseas investment and the boomerang effect is coming and it will be substantial. Therefore, the present level of the exchange rate signifies that we have completed the adjustment. What the United States should do is not devalue the dollar but, rather, increase tax revenues. That is the opinion of majority of the economists in Japan. Well, I am in a minority, and I don't think the United States will increase taxes and I feel that we will experience a further appreciation of the yen. But I feel isolated in this opinion and I am rather shocked by the fact that most of the economists in Japan take an opposing view.

Murray Smith

I think that the economists who look at the purchasing power parity rate, the PPP rate, make a mistake because they ignore factors that lead to changes in the sustainable real-exchange rate. The PPP rate is not some magic rate ordained by the gods. Instead, it reflects the kind of exchange rate that would prevail over the long term if there were no other factors operating to change the real exchange rate. I have focused my research on how the changes in international asset positions, on the part of the United States, Japan, and Canada, imply that in the 1990s we will need different real exchange rates in order to have relatively balanced current account positions among the major trading countries. Of course, how macroeconomic policy unfolds in Japan, the United States and in Canada, and how private savings behaviour evolves, will influence the current account position of each of the major countries as well as the shorter term evolution of exchange rates. If you look again at Chart 6, which shows how large interest payments from Canada to Japan have become relative to the net trade flows, it is clear that those interest payments exert a powerful influence on what is the appropriate real exchange rate and that eventually those interest payments will over-ride the influence of almost any surplus of savings over investment in the effects on the trade balance. Even if Japan were to run a current account surplus of 2 percent of GNP for the next 15 years then, sometime in the mid-1990s, Japan would move into a deficit on merchandise trade, because the interest payments from abroad on that foreign investment would surpass the current account surplus, which would lead to changes in the real exchange rate.

On the point about United States protectionism, I believe that the peak has past and that we may escape without serious damage to the bilateral relationships of either

Canada or Japan with the United States, and indeed without serious damage to the world trading system. That itself is something to take pleasure from.

I have also argued strenuously, with people from the United States, the point that Dr. Kosai makes. It is because 30 percent of Japanese exports to the United States are subject to voluntary export restraints and other restrictions on trade that the devaluation of the dollar since 1985 has had less of an effect on the bilateral trade balance than traditional j-curve analysis would suggest. Until the yen/dollar rate reaches a level where the Japanese automotive manufacturers find that their costs impel them to raise the price of automobiles in the United States market above the price under the voluntary export restraints, the exchange rate movement will have very little effect on the trade volume. In 1987 Japan did not fully utilize its quota for automotive exports to the United States. That suggests to me that, at this level, the dollar/yen rate is finally beginning to bite on trade flows. If the yen were to go to 100 to the U.S. dollar it would have a much more pronounced effect on automotive, steel, or textile trade between Japan and the United States than the move from 260 yen to the United States dollar to 150 yen to the United States dollar. We are now moving to the point where the trade restrictions that the United States has imposed are no longer as binding on the trade between Japan and the United States.

I do expect that the attitude of the United States towards Japan is likely to continue to be protectionist but I expect a gradual shift in a more benign direction, just as attitudes to Canada have moved—but, perhaps, with a considerable lag in the case of Japan. The United States has focused too much attention on the bilateral trade surplus that Japan has with the United States. I think it reflects both the underlying pattern of comparative advantage of Japan and the United States and the balance of payments developments which have been so violent in the 1980s. But I hope that Japan will display the kind of patience with Canada that the United States should have displayed with Japan in the 1980s, when Canada runs a large surplus with Japan in the late 1990s.

Mikiko Iwasaki

I would like ask a question about the dispute-settlement mechanism of the Canada-U.S. Free Trade Agreement. What are the rules for settling disputes and are they binding?

Murray Smith

There are three different principal dispute-settlement mechanisms in the Canada/U.S. Free Trade Agreement and two or three smaller ones that are important in particular sectors like the financial sector. I will focus on the one that has been the most contentious, that is the antidumping and countervailing duty laws, and I will touch on the other main one, the general dispute settlement mechanism.

The dispute settlement process on the antidumping and countervailing duty laws, for the moment, proposes a new binational, binding appeal process from final decisions of

the national authority in either country about antidumping or countervailing duty laws. It defers for a period of up to five to seven years, the negotiation of bilateral rules regarding unfair trade, including subsidies, countervailing duties and antidumping duties. Evaluating just that mechanism is a complicated technical exercise, and it raises a set of deeper judgements. It is my view that the binational appeal process that is in the Canada/United States Agreement will not effect most countervailing and antidumping cases that occur between Canada and the United States, but it will prevent abuse of the system. As a Canadian, I would argue that in the recent softwood lumber dispute there was abuse of the domestic administrative apparatus in the United States in response to political pressure. I do not believe that the second softwood lumber case in 1986, where the Department of Commerce suddenly reversed its decision of three years earlier and ruled that the stumpage policies of Canadian provinces (notably British Columbia) were considered to be unfair subsidies, would have happened if this binational appeal process had been in place. I hope that we never need to use the binational appeal process, but having the alternative there will help to depoliticize, or insulate, the administration of antidumping or countervailing duties from political pressures in the United States and Canada. Given our recent experience with the United States (and I am sure that people in Japan can understand that when the United States goes through these mood swings they become very protectionist), having some insurance against that type of political pressure is useful in itself. Also, as I suggested earlier, the turnaround in the bilateral accounts in both Canada and the United States that will flow from exchange rate adjustments, will make it much easier for Canada and the United States to negotiate these unfair trade issues in the years ahead.

Not enough attention has been paid to the general dispute-settlement mechanism in the Canada/U.S. agreement. It provides both a binding mechanism, if both countries agree, and it also provides a mechanism which is not binding, but advisory. I would suggest that even the advisory mechanism under the general dispute-settlement mechanism constitutes a considerable improvement over the kinds of dispute-settlement mechanisms that now operate within the GATT. In fact, proposals that the United States and other countries have made for reform of the GATT dispute-settlement process parallel the elements embodied in the Canada/United States Free Trade Agreement. I hope that the GATT mechanism is strengthened because, if GATT dispute settlement is functioning well, it will buttress the Canada/U.S. dispute-settlement agreement and *vice versa*. Both countries keep their rights to take any dispute either to the GATT or to the Canada/U.S. Agreement, so this is why I say the dispute-settlement provisions under the agreement are woven with the GATT. They are not separate. It is a mutually reinforcing relationship.

*Demographic Aging in Canada: Implications for Public Policy**

Shirley B. Seward
Institute for Research on Public Policy

Introduction

Demographic aging is a reality shared by all the major industrialized countries in the world. In some countries, such as Sweden, the United Kingdom and the Federal Republic of Germany, the process is well advanced. By contrast, the populations of Canada, Japan and the United States are relatively youthful, but certainly much older than the populations of the developing world. (Heller, Hemming and Kohnert (IMF) 1986; McDaniel 1986)

Given these global trends, it is not surprising that considerable debate has emerged on the social and economic consequences of demographic change, and the implications for public policy. Numerous studies, including comparative international analyses, have been undertaken to assess the impact on social expenditure, and the need to reform social programs in order to accommodate demographic change and to contain costs (see, for example, Heller, Hemming and Kohnert (IMF), 1986; and OECD 1985).

This paper considers the implications of demographic aging for the Canadian economy and for public policy. While the paper will address the usual areas of social policy such as health care, emphasis will be placed on public policy issues which go beyond the traditional boundaries of social policy into broader concerns that are generally considered part of economic and labour adjustment policy. In particular, consideration will be given to the extent to which aging of the labour force may complicate labour

---

* This paper is based, in part, on the following previous studies by the author: Seward 1987a, 1987b, 1987c and 1987d.

market adjustment in a changing Canadian economy. Furthermore, the paper examines the role of immigration as an instrument for dealing with demographic change and, indeed, as a tool for economic growth.

Part one of the paper reviews major recent demographic trends in Canada, with particular emphasis on developments over the past decade. Part two projects these demographic trends over the next several decades, with likely scenarios to the end of the century. Part three assesses the implications of recent and projected demographic changes for the economy and for public policy in the late 1980s and the 1990s, particularly the potential adjustment problems associated with a labour force that is growing more slowly and aging, as well as the effects of population aging on the demand for public expenditure. Part four assesses the role immigration has played, and might continue to play in the future, in overcoming some of the potential problems associated with demographic change. The concluding section stresses the importance of economic-social-demographic relationships, and reinforces the need for a broader approach to social policy reform.

1. Recent Demographic Trends

Over the past 30 years, the annual rate of population growth has declined steadily, from 3 percent in 1957 at the height of the baby boom, to less than 1 percent in 1984. The most striking demographic trend in recent decades was the dramatic increase in fertility levels that began in the late 1940s and subsided in the mid-1960s. The result was the emergence of the big generation, or the baby boom generation, which includes individuals born between 1947 and 1966; the peak of the boom occurred in 1961. In the early 1960s, however, fertility rates began to decline very rapidly; during the past decade they have continued to decline at a slower rate. By 1985, the fertility rate was less than 1.7 children per women, considerably below the replacement level (Seward 1987a).

At the same time, there has been substantial variation in annual gross immigration flows. The post-war period saw an upsurge of immigration. During the period of rapid economic growth in the 1950s and 1960s, an average of 130,000 immigrants entered Canada each year, with wide fluctuations reflecting economic conditions in Canada and the countries of origin, as well as the "tap-on, tap-off" approach to Canadian policy on immigration levels, which based decisions on short-term labour force considerations. By 1974, immigration had reached almost 220,000. At that point, immigration policy became much more restrictive. This stance, together with recessionary conditions in the late 1970s and early 1980s, resulted in immigration declining, from approximately 150,000 in 1976 to just over 84,000 in 1985 (Seward 1987d).

Very recently, the number of immigrants has again increased, to just under 100,000 in 1986 and an estimated 150,000 in 1987. This was the result, at least in part, of a rethinking of immigration policy by the Conservative government elected in September 1984, which called for a "moderate, controlled increase" in immigration levels in order to

stimulate economic and population growth. (For a fuller discussion of the evolution of immigration policy, see Seward 1987d.)

These demographic trends have had a major impact on the size and rate of growth of the labour force over the past decade (Table 1). Between 1975 and 1980, the labour force grew at an average annual rate of 3 percent. Two-thirds of this growth was attributable to source population (domestic and net immigration) growth and one-third to increases in participation rates. It is interesting to note that, while the average annual rate of growth in participation of the total population was 1 percent over this period, participation by women grew by 2.6 percent, while participation by men showed no growth at all.

The period 1980-1985 saw a decline in the rate of average annual labour force growth to 1.8 percent, significantly lower than the 3 percent rate during the latter half of the 1970s. This decline resulted from a slowdown in the rate of growth in the source population to 1.4 percent, mainly because of the much smaller cohorts following the baby boom generation into the labour force. An additional factor was the slower growth of participation rates, from an average of 1 percent annually between 1975 and 1980 to 0.3 percent during the period 1980-1985. This decline in the growth of participation rates was caused, at least in part, by the economic recession of the early 1980s. Once again, it is interesting to note that the average annual growth in participation rates for women (1.5 percent) was significantly higher than that for men (-0.4 percent).

These trends in growth rates have significantly affected the composition of the population and the labour force. The Canadian population has been aging gradually in recent decades. As shown in Table 2, the proportion of the population under the age of 20 declined from a peak of 42.2 percent in 1966 to 28.9 percent by 1986. On the other hand, the proportion of the population over 65 increased from 7.7 percent in 1966 to 10.7 percent in 1986. As a result, the young dependency ratio (defined here as the population under age 20 as a proportion of the population aged 20-64) declined significantly over this period from .84 to .48; at the same time, the old dependency ratio (the population aged 65 and over as a proportion of the population aged 20-64) increased slightly, from .15 to .18. Thus, the increase in the old dependency ratio was more than offset—at least numerically—by the decline in the young dependency ratio, and the total dependency ratio fell from 1.99 in 1966 to 1.65 in 1986. The implications of these dependency ratios, especially when projected, will be considered later in this paper.

The aging of the population has had a direct effect on the age structure of the labour force in the past 10 years (Table 3). By 1975, the leading majority of the baby boom generation had entered the labour force, resulting in rapid growth of the two younger age groups (15-24 years and 25-34 years) over the period 1975-1980. By the early 1980s, however, the majority of these youth had matured into young adults, and the post-baby boom cohorts entering the labour market were much smaller. Therefore, the most rapid growth of the labour force over the period 1980-85 was in the older groups—those aged 25-34 and, especially, 35-44.

2. Future Demographic Trends

A range of projections of the future population and labour force has been developed by federal government departments, especially Statistics Canada, and by individual researchers and academics. For example, Denton and Spencer (1987a, b) prepared projections using several scenarios or different sets of assumptions regarding fertility, mortality and net immigration levels. For purposes of illustration, references in this paper are to the projection incorporating "medium" assumptions. In this projection, the total fertility rate remains at 1.7 throughout the projection period; net immigration is 50,000 per year; and mortality rates continue to decline (for most age-sex groups) until the year 2031, but at a decelerating rate.

On the basis of these assumptions, the demographic trends projected over the coming decades will follow the patterns established in the 1970s and 1980s. The overall rate of population growth will decline steadily; the proportion of the population under the age of 20 will fall; and the proportion aged 65 and over will rise, from an estimated 10.7 percent in 1986 to 13.4 percent in 2001 and 25.1 percent by 2036 (Table 4).

What are the implications of these trends for population-based dependency ratios? The old dependency ratio (defined above) continues to rise over the entire projection period, while the young dependency ratio falls, at least until 2016. The total dependency ratio falls until 2011, after which it rises. But even at its peak in 2036, the total dependency ratio of 1.83 is lower than the level of almost 2.00 that prevailed in the 1960s (Table 4).

Using the same medium assumptions projection, and assuming that labour force participation rates follow the trends of recent decades (i.e., female rates continue to rise and rates for older males continue to decline), Denton and Spencer project that the decline in the rate of growth of the labour force, that began in the 1980s continues, for several decades until the rate actually becomes negative in 2016. The total dependency ratio (defined here as the ratio of the total population to the labour force) declines from 1.98 to 1.89 between 1986 and 2001, after which it begins to rise (Table 5).

Clearly, these projections based on medium assumptions represent only one possible scenario for the future. Denton and Spencer explored other sets of assumptions but, with the possible exception of the "high fertility" projection (in which the total fertility rate is assumed to rise in equal annual increments from 1.7 to 3.0 births per woman by 1996, remaining at that level thereafter), the general population and labour force patterns are broadly similar to those described for the medium-assumptions projection. It is difficult to have confidence in projections over several decades into the future, but shorter time frames permit more realistic scenarios. At least until the end of the century, it is likely that the population and labour force will age gradually; the rate of growth of the population and the labour force will decline (although both will remain positive); and, whereas the total population and labour force dependency ratios will decline, population dependency ratios will increase for the elderly population and decrease for the young.

3. The Implications of Population Aging for the Canadian Economy and Public Policy

In this section, we focus on the implications of these demographic trends to the end of the century by exploring two concerns: the burdens that will be placed on governments to provide programs such as pensions and health care to an increasing population of elderly people, and the capacity of the labour force to adapt in a changing economy.

Demand for Public Expenditure

A number of Canadian studies have projected the likely effect on overall government expenditures of the declining demand for some services, such as education for the decreasing youth population, and the accelerating demand for other services, such as health care and income transfers in the form of pensions for the increasing number of elderly people. The scope of this paper does not permit a full discussion of the results of these studies. It is worth noting, however, that most researchers have concluded that the overall cost to the public sector appears manageable, at least until the turn of the century, but the federal level of government will bear a disproportionate share of the costs (Foot 1987a). This is because the most burdensome items—income transfers to the elderly—are primarily the responsibility of the federal level of government.

Analyses of the impact of the changing age structure of the population are frequently couched in discussions of dependency ratios. As discussed above, the total population and labour force dependency ratios are likely to decline by the end of the century, with the rising elderly dependency ratio being more than offset—at least in a numerical sense—by the declining youth dependency ratio. Since the taxable base of the population will remain large as a result of the presence of the baby boom generation in the labour force, it would appear that the overall dependency ratio, at least to the end of the century, will not be onerous and in fact will be lower than levels experienced in Canada in earlier decades.

At a superficial level, this conclusion appears reassuring. However, as Foot (1987a) has pointed out, this traditional approach to assessing dependency ratios makes a number of assumptions that may have to be questioned: first that, on a per capita basis, expenditures on the young are the same as those on the elderly; second, that all members of the working age population are gainfully employed and do not depend on public resources; and third, that resources can be transferred readily from the young to the elderly.

With respect to the first assumption, Foot estimates that per capita government expenditures on the elderly are roughly two-and-a-half times greater than those on the young. Thus, "a rising elderly ratio even if exactly offset by a declining youth ratio, would result in an *increase* in government spending . . ." (Foot 1987a, 6).

The second assumption is that all members of the labour force source population are gainfully employed. However, in 1985, less than two-thirds of the male and female source population participated in the labour force (recall Table 1). Furthermore, even for those in the labour force, unemployment rates are high and may remain high. Thus, labour force participation rates and unemployment affect the size of the productive and taxable population base. Also, unemployment is associated with government expenditures on income support programs such as unemployment insurance and welfare. Moreover, as will be discussed below, in a changing economic environment characterized by adjustment challenges, public programs such as training and mobility assistance for displaced workers will also drain public resources. Thus, youth and the elderly are not the only members of society who may pose a dependency burden.

Finally, the third assumption is that resources can be transferred readily from youth to the elderly population. Thus, for example, the resources spent on education for the young can be redirected to pensions or health care for the elderly. However, there will be adjustment costs associated with the dislocation of workers in the teaching occupation, and the existing education infrastructure (buildings, equipment, supplies and so on) may not be readily transferrable to other uses. Furthermore, different levels of government are responsible for different types of public expenditures. Transferring resources from youth to the elderly may therefore imply the renegotiation of federal-provincial cost-sharing arrangements—and this would be by no means a straightforward task.

In summary, population and labour force aging are occurring at a time when the economy is changing rapidly and when unemployment levels remain relatively high. This combination of demographic and economic forces is placing considerable pressure on federal and provincial governments to provide income support for the long-term unemployed, as well as training and mobility assistance for displaced workers. Ironically, these increased demands on social expenditures are occurring at a time when governments are faced with the prospect of increasing costs for the provision of income support and health services to the growing elderly population.

These new pressures and demands are forcing governments and policy analysts to re-assess the nature of social welfare systems in Canada. Debate is growing on how best to reform social programs such as health care and pensions in order to better meet the needs of an aging society and, equally important, to contain costs. While it is not possible to provide details of these programs within the scope of this paper, it is useful to give a general sense of the magnitude of the cost of social expenditure to the federal government, and to illustrate, by reference to the health care system, the type of reforms that are under discussion.

As shown in Table 6, the cost to the federal government of the major social programs in 1986-87 was estimated to be approximately $60 billion.* (In 1986 total Canadian GDP was approximately $510 billion.) Of this $60 billion, approximately $12 billion, or 20 percent of total federal social expenditure was devoted to health care.

---

* Not only the federal government contributes to social programs. If expenditure on major social programs by all levels of government are considered, the total estimated cost for fiscal year 1986-87 was approximately $100 billion (Courchene 1987, 27).

At the provincial level, the cost pressures appear to be just as, if not more, acute. In Ontario, health expenditures accounted for 28.5 cents of the provincial expenditure dollar in 1981-82 and 30.9 cents in 1984-85, and, in absolute terms, increased by 58 percent during this period (Courchene 1987, 138). The prospect that these costs are likely to increase further with population aging is generating considerable concern.

There is little question that Canadians support the concept of a publicly provided health system. However, within such a system, there is considerable scope for rationalization and more efficient use of resources (Stoddart 1985 cited in Courchene 1987). Examples of how such rationalization might be introduced include:

- the use, where appropriate, of more nurse practitioners or paramedics instead of physicians. According to one study, this would reduce costs by about 7 percent (Denton and Spencer 1982, p.12 and McDaniel 1986, p.85);
- the use of alternative facilities to hospitals. These might include convalescent homes, extended-care facilities, nursing homes and patient homes (Courchene 1987);
- a greater emphasis on preventive care, with a view to enhancing the health of the population, and minimizing the use of the curative system (McDaniel 1986).

Labour Market Flexibility and Adaptability

A labour force that is growing more slowly will mean fewer young labour market entrants in the late 1980s and the 1990s. In 1980, there were over 3 million youth in the Canadian labour market, representing more than one-quarter of the labour force. By 1985, their share had dropped to 22.6 percent. By the end of the century, given current participation rates, their share might fall to 17 percent (Foot 1987b). This decline in the relative number of young labour market entrants could lead to a labour force that is less flexible and mobile from a geographical, occupational and industrial perspective.

> These persons are presumed to be the most flexible with respect to location and occupation. They possess up-to-date labour market skills, and do not have a work history tying them to any particular organization or occupation. Moreover, they are not already part of an organization's bureaucracy and hence represent resources which can be deployed in the most efficient manner without disruptive costs to both employer and employee. At the margin they are by far the most adaptable resource available to an organization and their deployment facilitates growth in an ever-changing marketplace.
>
> (Foot 1987b, 8)

To a certain extent, however, the smaller number of new labour market entrants could be offset, at least until the end of the century, by expected gains to be reaped from the presence in the labour force of the large, gradually aging and relatively well-educated baby boom generation, whose members are now in their twenties and thirties. Major

investments were made in educating the members of these cohorts, and one would logically expect a pay-off from such an investment, particularly as workers gain on-the-job experience. Thus, "age-related productivity gains may act as an offset to the reduction in numbers associated with slower labour force growth" (Denton and Spencer 1987b, 10).

Four caveats should be noted in discussing the potential productivity gains associated with the presence of the baby boom generation in the labour force (Foot 1987b). First, the education obtained by the current labour force in the 1950s and 1960s may well be inappropriate in the late 1980s and 1990s, particularly given the changing economic environment and technological change. Furthermore, the returns to such investments already appear lower than originally expected, as the supply of individuals with higher education has grown. Second, training and retraining, to update skills and facilitate adjustment are of critical importance. This suggests that governments may have to expend more resources on such programs as the aging of the labour force continues. Third, the expected productivity gains associated with on-the-job experience may not be fully realized, given the high youth and young adult unemployment rates that have characterized the past decade and still prevail. There is little understanding of the potential long-term effects of youth unemployment on overall labour market productivity and personal labour market potential, and efforts will need to be made to assist the unemployed in making the transition from dependency to active involvement in the labour force. Finally, the aging process may make the baby boom labour force less mobile—from a geographic perspective—thereby impeding the adjustment process.

These concerns about potential difficulties of labour market flexibility become more serious in the context of current economic conditions in Canada. Over the past decade, the Canadian economy has been characterized by declining growth in productivity, rising unemployment, and falling standards of living. While some improvements have occurred since the 1981-1982 recession, productivity growth remains minimal, and unemployment—particularly for young adults—remains high. At the same time, the 1970s and 1980s have witnessed the increasing integration and interdependence of the global economy, characterized by higher levels of trade and a more complex range of trading relations; accelerated technology transfer; and substantially greater international capital flows. To an increasing extent, domestic economic growth has become linked with international competitiveness (Seward 1987a). Indeed, the federal government's initiative in developing a free trade agreement with the United States implies that Canada will have to be able to compete in order to take advantage of larger markets.

This interplay between demographic and economic change raises a number of key questions. To what extent will the aging Canadian labour force be able to adjust in a changing economic environment? Will the costs of adjustment be prohibitive, particularly since governments are also likely to be faced with an increasing burden in providing social programs such as health care and pensions to a growing population of elderly people? Are existing social programs and labour adjustment programs adequate, given current levels of unemployment, and the prospect—at least in the short term—of displaced workers which will accompany changing trade patterns and other types of economic change?

Labour market tracking studies in Canada shed some light on these issues. One such study is a national survey of workers who lost a full-time job between 1981-1984 (Picot and Wannell 1987). The study analyzes the incidence of job loss among different groups, and their labour market adjustment experience up to the end of 1985. The major finding of the study is that particular demographic groups, particularly older workers, women and workers with low levels of education, not only faced more difficulty in securing new, permanent jobs, but also were much less likely to take advantage of government labour adjustment programs such as training and mobility assistance.

From the perspective of this paper on demographic aging, the experience of older workers merits more elaboration. According to Picot and Wannell, of those displaced older workers who remained in the labour force, 34 percent were unemployed in January 1986—an unemployment rate more than three times the national average. Older workers were also the least likely to retrain (6 percent took some form of training compared to 20 percent of younger workers) and the least likely to move to accept or seek employment (9 percent compared to 20 percent of younger workers). While the study focused on older workers 55 years and over, it also found increased difficulty in labour force adjustment in the 45-54 age group as well.

The difficulties faced by older workers, including those as young as 45, is particularly worrisome given the aging of the Canadian labour force and diminishing relative proportion of younger workers. The low utilization of government training and mobility programs by displaced older workers during the first half of the 1980s suggests that there is a pressing need to modify existing programs and to encourage greater participation by older workers.

At a more general level, it is also essential to reform existing income security programs for unemployed workers in order to encourage their movement back into the active labour force. The two most important programs are unemployment insurance (UI) and welfare, which is provided within the Canada Assistance Plan (CAP). The following discussion will focus on the first of these programs.

Unemployment insurance is the largest single program within the federal social policy envelope, accounting for $11.5 billion in 1986-87, or approximately 19 percent of total federal social program expenditures (Table 6). It should be noted, however, that approximately $8 billion of this total is financed by employee and employer contributions (Courchene 1987, 62).

There are three basic criticisms of the existing unemployment insurance program. First, many argue that it is too generous in terms of benefit levels, duration and eligibility requirements. Second, some critics contend that it removes the incentive to return to the labour force. And third, it is viewed by some analysts as too broad, incorporating not only a critical social insurance component, but also a range of socio-economic programs including regionally extended benefits, special benefits for self-employed fishermen and the use of UI funds to facilitate work-sharing, job creation and skill training activities (Courchene 1987, 61-62).

During the 1980s, a number of proposals for reform of UI were developed. At the provincial level, the Newfoundland Royal Commission on Employment and Unemployment (House Report 1986) proposed an earnings supplementation plan and reform of UI in order to encourage local job creation activities. At the federal level, the majority report of the Commission of Inquiry on Unemployment Insurance (Forget Commission 1986) "sought to restore the primary focus of unemployment insurance as social insurance, while eliminating UI's social welfare role. Forget proposed to deal with the latter through a new national income supplementation program for the working poor and the long-term unemployed." (Dobell 1987)

Unfortunately, the political consequences of major reform of unemployment insurance are considered too high at the present time, and the federal government has chosen not to act on the proposals for change. This is regrettable, since the current system does little to facilitate the movement of unemployed people from dependency back to active participation in the labour force.

4. The Role of Immigration

The above discussion has focused on the types of social policy reform that may be required in the context of demographic aging and economic change. Reform is debated on the assumption that demographic aging is inevitable, and that public policy must accommodate demographic change. However, an alternative or complementary approach is to consider policies which have a direct impact on demographic factors, through their influence on the rate of population growth and aging. Two such policies are the encouragement of higher fertility and the encouragement of higher net immigration (by increasing gross immigration and endeavouring to stem emigration). It is sometimes argued that higher fertility could be encouraged by a range of public policies which would lessen the costs of having children. Indeed, a number of industrialized countries have developed explicit pro-natalist policies and programs such as family-founding loans, family or child allowances, financial assistance for child care and tax exemptions for children or for spouses. It would appear, however, that except for a few socialist countries in Eastern Europe, these policies have had only marginal effects on fertility levels (Burch 1986).

This points to higher net immigration as the critical public policy lever for increasing the overall size and rate of growth of the population. Given the reluctance of Canadian governments to stem free movement of people by restricting emigration, immigration policy tends to concentrate on the level and composition of immigration flows as the key mechanism for meeting demographic and economic objectives.

It is estimated that, over the century 1881-1981, net immigration accounted for one-fifth of total population growth, while natural increase accounted for four-fifths. In recent years, the absolute level of natural increase remained relatively stable, despite a gradual decline in the fertility rate from 1.83 in 1976 to 1.69 in 1984. By contrast, net annual immigration levels exhibited considerable variation during the same period. As a

result, the magnitude of the role played by net immigration has fluctuated dramatically. In 1985, when net immigration was very low (36,600) it accounted for only 15.4 percent of total annual growth of the population, much lower than the 22 percent average annual contribution of net immigration to population growth over the previous 10 years (Table 7).

Immigration has also affected the age structure of the Canadian population. The age composition of the total stock of the immigrant population differs from that of non-immigrants. The immigrant population tends to be older. Based on census data, the average age of immigrants was 43 in 1981, compared to about 30 for non-immigrants. Those under age 20 accounted for only 12 percent of immigrants but 36 percent of non-immigrants. By contrast, 17 percent of immigrants were 65 or over in 1981, while only 8 percent of non-immigrants were in this age group (Statistics Canada 1984).

On the basis of this evidence, it would appear that immigration is contributing to the aging of the population. However, this conclusion is misleading because it does not take into account the fertility behaviour of immigrants after their arrival in Canada. Quite appropriately, the children born to immigrants after their arrival are not considered immigrants, because they are Canadian-born. Thus, the contribution of immigration to overall population growth is underestimated, and the average age of the immigrant population is higher than it would be if the children of immigrants were included in the calculation.

In addition to increasing the size and rate of growth of the population, immigration also has a direct impact on the size and composition of the labour force, which in turn affects the productive capacity of the economy. Net immigration's contribution to the growth of the source population has varied considerably over the last 30 years. During the period 1951-1956, net immigration accounted for over 47 per cent of its growth. By contrast, during the period 1979-1983, net immigration accounted for only about 18 percent of the growth of the source population (calculations based on Table 7). This was in part because of falling immigration levels in the early 1980s and in part because of a gradual decline in the proportion of immigrants destined for the labour force. Whereas in 1970, 53 percent of all immigrants were destined for the labour force, this proportion had fallen to 44 percent by 1984 (Samuel and Francolini 1985).

To a certain extent, however, immigration's contribution to the size of the source population understates its overall contribution to the growth of the labour force. This is because the participation rate of immigrants, when controlled for age, is higher than that of non-immigrants. In 1981, the age-adjusted participation rate of immigrant men was 79.4 percent, compared to 77.9 percent for non-immigrants. The differential for women was even greater, with a participation rate of 55.6 percent for immigrants compared to 50.6 percent for non-immigrants (Statistics Canada 1985).

Immigration has also affected the composition of the labour force, particularly in terms of education, skill and occupational characteristics. Canada has traditionally relied heavily on immigrants to supply skilled labour needs. During the 1950s and 1960s, over 40 percent of all immigrants destined for the labour force intended to enter professional, technical or skilled occupations. Moreover, the proportion of immigrants

intending to enter professional and technical occupations increased from 4 percent in 1951 to 27 percent in 1971. At the same time, immigrants intending to enter unskilled occupations dropped from 43 percent in 1951 to 14 percent in 1971 (Parai 1974 and Library of Parliament 1986). This shift was attributable, at least in part, to the 1967 points system, which gave preference to highly educated and skilled immigrants. In more recent years, this trend has continued. In 1984, 22.4 percent of immigrants destined for the labour force were in professional and administrative occupations (CEIC 1986), many of which historically have been characterized by labour shortages. This is not surprising, given that in 1981, a higher proportion of immigrants (10.5 percent) than non-immigrants (8 percent) had university degrees (Seward 1987d).

What are the implications of these historical trends for the future? In particular, can immigration be expected to affect population and labour force growth significantly and can it potentially facilitate economic adjustment?

As already shown, immigration has contributed significantly to the rate of population growth, even though its contribution has declined in recent years. While natural increase is clearly more important, fertility rates have been declining steadily, and the evidence from many other industrialized countries suggests that the decline may continue (Taylor 1986). If the current expansionist immigration policy of the federal government continues, it is likely that immigration will play an important role in population growth in the future. Similarly, given the declines in labour force growth rates projected to the end of the century, immigration will become a more important force, particularly since the participation rates of immigrants historically have been higher than those of non-immigrants. Furthermore, if trends continue, immigration is likely to bring new skills to Canada at a time when adjustment pressures may create skill shortages and special needs. Also, since immigrants tend on average to be more highly educated than non-immigrants, their occupational mobility may be higher.

Thus, immigration has the potential to facilitate adjustment and to alleviate dependency burdens associated with an aging population. Whether immigration can in fact fulfill this potential will depend on a number of factors. First, will the current federal government policy of increasing immigration continue in the future, and will the targets be met every year? Second, what categories of immigrants are likely to come to Canada in the future? The current federal government is placing considerable emphasis on encouraging independent immigrants (including business immigrants) who are destined to the labour force. Will Canada be able to compete for such immigrants? And to what extent will non-economic pressures, such as international refugee movements, change the composition of immigrant flows in the future? Finally, are Canadians adequately prepared to function in an increasingly multicultural society, characterized by a growing proportion of immigrants from Third World countries? The answers to these questions may well influence the demographic and economic role that immigration will play in the future.

Conclusion

Economic change and demographic pressures are forcing Canadian federal and provincial governments to seek reform of traditional social programs. Increasingly, however, it is recognized that social policy must be discussed in the context of broader socio-economic-demographic relationships.

In this context, it is essential that social policy and labour adjustment programs be reformed to accommodate the reality of demographic and economic change. While there is certainly a need to rationalize traditional social programs, such as the health care system, there is perhaps even greater urgency to develop appropriate labour adjustment programs, including training, mobility assistance and job creation activities. For, unless the labour force population is flexible and productively engaged, it will not be able to adapt to a changing environment nor will it be able to support an increasing proportion of elderly people. Finally, the potential role of immigration in stimulating population growth, stemming population aging and fueling economic growth assumes more importance than ever. It is not surprising, therefore, that the discussion of immigration issues has become a key topic of policy debate in Canada in recent years.

References

Burch, Thomas K. 1986. "Pronatalist Policies: An Appraisal With Special Reference to the Canadian Demographic Situation." Discussion Paper 86-1. London: The University of Western Ontario. December.

Courchene, Thomas J. 1987. *Social Policy in the 1990s. Agenda for Reform*. Montreal: C.D. Howe Institute.

Denton, F.T. and B.G. Spencer. 1982. "Population Aging and Future Health-Care Costs in Canada." Quantitative Studies in Economics and Population, Report No. 35. Hamilton: McMaster University.

Denton, F.T. and B.G. Spencer. 1987a. *Population Change and the Canadian Economy: A Survey of the Issues*. Discussion Paper 87.A.2 Ottawa: Institute for Research on Public Policy.

Denton, F.T. and B.G. Spencer. 1987b. *Population Change and the Future Labour Force: A Discussion Paper*. Discussion Paper 87.A.3 Ottawa: Institute for Research on Public Policy.

Dobell, Rod. 1987. Foreword. In *Approaches to Income Security Reform*, eds. Shirley B. Seward and Mario Iacobacci. Halifax: Institute for Research on Public Policy.

Employment and Immigration Canada. 1986. *Immigration Statistics 1984*. Ottawa: Supply and Services.

Foot, D.K. 1987a. *Population Aging and Government Deficits in Canada.* Discussion Paper 87.A.4. Ottawa: Institute for Research on Public Policy.

Foot, D.K. 1987b. *Population Aging and the Canadian Labour Force.* Discussion Paper 87.A.5. Ottawa: Institute for Research on Public Policy.

Heller, Peter S., Richard Hemming and Peter W. Kohnert. 1986. *Aging and Social Expenditure in the Major Industrial Countries, 1980-2025.* Washington: International Monetary Fund, September.

Library of Parliament. 1986. *Immigration and the Canadian Labour Market.* Backgrounder prepared by Kevin B. Kerr, Economics Division, Research Branch. Ottawa: Library of Parliament.

McDaniel, Susan A. 1986. *Canada's Aging Population.* Toronto: Butterworths.

Organization for Economic Co-operation and Development (OECD). 1985. *Social Expenditure 1960-1990. Problems of Growth and Control.* Paris: OECD.

Parai, L. 1974. *The Economic Impact of Immigration.* Ottawa: Department of Manpower and Immigration.

Picot, Garnett and Ted Wannell. 1987. "Job Loss and Labour Market Adjustment in the Canadian Economy." *The Labour Force.* Statistics Canada Catalogue No. 71-001. Ottawa: Supply and Services, March.

Samuel, J. and S. Francolini. 1985. "Current Demographic Trends in Canada." Mimeo. Ottawa: Employment and Immigration Canada.

Seward, S.B. 1987a. *Demographic Change and the Canadian Economy: An Overview.* Discussion Paper 87.A.0. Ottawa: Institute for Research on Public Policy.

Seward, S.B. 1987b. "Demographic Change and the Canadian Economy: An Overview." *Canadian Studies in Population* 14(2): 279-299.

Seward, S.B. 1987c. "Demographic Change, the Canadian Economy and the Role of Immigration." In *The Future of Social Welfare Systems in Canada and the United Kingdom*, ed. Shirley B. Seward. Halifax: Institute for Research on Public Policy.

Seward, S.B. 1987d. *The Relationship Between Immigration and the Canadian Economy.* Discussion Paper 87.A.10. Ottawa: Institute for Research on Public Policy.

Statistics Canada. 1984. *Canada's Immigrants.* Ottawa: Supply and Services.

Statistics Canada. 1985. *The Labour Force.* Ottawa: Supply and Services.

Stoddart, Greg L. 1985. "Rationalizing the Health-Care System." In *Ottawa and the Provinces: The Distribution of Money and Power*, eds. Thomas J. Courchene, David W. Conklin and Gail C.A. Cook. Toronto: Ontario Economic Council.

Taylor, C. 1986. "Demography and Immigration in Canada: Challenge and Opportunity." Paper Presented to the Fall Conference of the Association for Canadian Studies in the Netherlands, October 1986.

Table 1
Components of Labour Market Growth, Canada
1975-85

	Level[1]			Growth[2] (% p.a.)	
	1975	1980	1985	1975-80	1980-85
BOTH SEXES:					
Source Population	16.323	18.053	19.372	2.0	1.4
Participation Rate (%)	61.1	64.1	65.2	1.0	0.3
Labour Force	9.974	11.573	12.639	3.0	1.8
Employment	9.284	10.708	11.311	2.9	1.1
Unemployment	0.690	0.865	1.328	4.6	9.0
Unemployment Rate (%)	6.9	7.5	10.3	1.7	6.6
MALES:					
Source Population	8.026	8.847	9.468	2.0	1.4
Participation Rate (%)	78.4	78.4	76.7	0.0	-0.4
Labour Force	6.294	6.935	7.258	2.0	0.9
Employment	5.903	6.459	6.508	1.8	0.2
Unemployment	0.391	0.476	0.750	4.0	9.5
Unemployment Rate (%)	6.2	6.9	10.7	2.2	9.2
FEMALES:					
Source Population	8.297	9.206	9.904	2.1	1.5
Participation Rate (%)	44.4	50.4	54.3	2.6	1.5
Labour Force	3.680	4.638	5.382	4.7	3.0
Employment	3.381	4.249	4.804	4.7	2.5
Unemployment	0.299	0.389	0.578	5.4	8.2
Unemployment Rate (%)	8.1	8.4	10.5	0.7	4.6

Notes:

1. All levels in millions of persons unless otherwise indicated.
2. Average annual rate of growth.

Source: Foot, D. (1987, b), Table 2.

Table 2
The Population of Canada: Size, Growth, and Age-Distributional Characteristics 1951-1986

Year (June 1)	Total population ('000)	% Increase (previous 5 years)	Age distribution (%)			Dependency ratios		
			Under 20	20-64	65+	Total Pop. / Pop. 20-64	Pop. under 20 / Pop. 20-64	Pop. 65+ / Pop. 20-64
1951	14009	14.0	37.9	54.4	7.7	1.84	.70	.14
1956	16081	14.8	39.7	52.5	7.8	1.91	.76	.15
1961	18238	13.4	41.8	50.6	7.6	1.98	.83	.15
1966	20015	9.7	42.1	50.2	7.7	1.99	.84	.15
1971	21568	7.8	39.4	52.5	8.1	1.90	.75	.15
1976	22993	6.6	35.8	55.5	8.7	1.81	.65	.16
1981	24342	5.9	32.0	58.3	9.7	1.72	.55	.17
1986*	25591	5.1	28.9	60.5	10.7	1.65	.48	.18

* Preliminary estimates.

Source: Denton, F. and B. Spencer (1987, a), Table 1.

Table 3
Labour Force Source Population by Age, Canada
1975-85

	Population (millions)			Average Growth (% p.a.)	
	1975	1980	1985	1975-80	1980-85
BOTH SEXES:					
15-24 Years	4.297	4.554	4.244	1.2	-1.4
25-34 Years	3.428	4.027	4.410	3.3	1.8
35-44 Years	2.516	2.819	3.488	2.3	4.4
45-54 Years	2.420	2.454	2.498	0.3	0.4
55-64 Years	1.854	2.085	2.294	2.4	1.9
65+ Years	1.808	2.115	2.437	3.2	2.9
Total	16.323	18.053	19.372	2.0	1.4
Median Age (Years)	36.7	36.6	38.0	-0.1	0.8

Source: Foot, D. (1987, b), Table 3.

Table 4
The Projected Population, 1986-2036: Projection A ("Medium" Assumptions)

Year (June 1)	Total population ('000)	% Increase (previous 5 years)	Age distribution (%)			Dependency ratios		
			Under 20	20-64	65+	Total Pop. / Pop. 20-64	Pop. under 20 / Pop. 20-64	Pop. 65+ / Pop. 20-64
1986*	25591	5.1	28.9	60.5	10.7	1.65	.48	.18
1991	26783	4.7	27.6	60.6	11.7	1.65	.45	.19
1996	27765	3.7	26.6	60.6	12.8	1.65	.44	.21
2001	28524	2.7	25.5	61.1	13.4	1.64	.42	.22
2006	29131	2.1	24.0	61.8	14.1	1.62	.39	.23
2011	29648	1.8	22.7	61.9	15.4	1.62	.37	.25
2016	30063	1.4	21.8	60.6	17.6	1.65	.36	.29
2021	30318	0.8	21.4	58.7	19.9	1.70	.37	.34
2026	30367	0.2	21.1	56.5	22.3	1.77	.37	.39
2031	30219	-0.5	20.7	54.8	24.4	1.82	.38	.45
2036	29909	-1.0	20.3	54.6	25.1	1.83	.37	.46

* Preliminary estimates.

Source: Denton, F. and B. Spencer (1987, a), Table 3.

Table 5
The Projected Labour Force and its Relationship to the Population, 1986-2036: Projection A ("Medium" Assumptions)

Year	Population ('000; June 1)	Labour Force** ('000; annual average)	% Increase (previous 5 years)		Dependency Ratio (Pop./LF)
			Population	Labour force	
1986*	25591	12898	5.1	7.6	1.98
1991	26783	13767	4.7	6.7	1.95
1996	27766	14494	3.7	5.3	1.92
2001	28524	15090	2.7	4.1	1.89
2006	29131	15364	2.1	1.8	1.90
2011	29648	15418	1.8	.3	1.92
2016	30063	15163	1.4	-1.7	1.98
2021	30318	14770	.8	-2.6	2.05
2026	30367	14408	.2	-2.5	2.11
2031	30219	14083	-.5	-2.3	2.15
2036	29909	13862	-1.0	-1.6	2.16

* Preliminary estimates.
** Includes the armed forces.

Source: Denton, F. and B. Spencer (1987, a), Table 8.

Table 6
Major Federal Social Program Expenditures Fiscal Year 1986-87
($millions)

Policy area	Expenditures
Human resources development programs	
Skill development	1,284
Colleges and universities: cash transfers	2,380
Tax transfers	2,423
Job creation	600
Total tax transfers	2,423
Total direct transfers	4,264
Total	**6,687**
Income security programs	
Unemployment insurance	11,500
Canada Assistance Plan	4,059
Family allowances	2,531
Marital exemption	1,385
Child tax exemption	940
Child tax credit	1,435
Total tax transfers	3,760
Total direct transfers	18,090
Total	**21,850**
Retirement income security programs	
RRSP/RPP exemptions	4,900
Old age tax exemption	500
Pension income tax exemption	150
Old Age Security Program	9,510
Guaranteed Income Supplement	3,566
Spouses allowance	605
Total tax transfers	5,550
Total direct transfers	13,681
Total	**19,231**
Health Care	
Hospital care and physicians services	6,805
Transfer of tax points for above	5,119
Total tax transfers	5,119
Total direct transfers	6,805
Total	**11,924**
Total tax transfers	16,852
Total direct transfers	42,840
Total cost	**59,692**

Note: All tax expenditure costs for individuals are estimated based on 1983 tax returns. Costs for these measures in fiscal year 1986-87 are likely to be 10-20 per cent higher due to rising exemption levels.

Source: [illegible]rchene, 1987, Table 2.

Table 7
Basic Demographic Data for Canada, 1976-1985, by Calendar Year

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985*	Average
Total Population on January 1	22,883,900	23,158,400	23,417,400	23,644,500	23,911,900	24,221,300	24,511,800	24,782,600	25,021,400	25,263,800	24,081,700
Births	360,400	360,700	360,200	366,100	370,700	371,300	373,100	373,700	377,000	379,100	369,200
Deaths	167,200	167,500	168,200	168,200	171,500	171,000	174,400	174,500	175,700	178,400	171,660
Natural Increase	193,200	193,200	192,000	197,900	199,200	200,300	198,700	199,200	201,300	200,700	197,540
Birth Rate (%)	1.57	1.55	1.53	1.55	1.55	1.53	1.51	1.50	1.51	1.50	1.53
Death Rate (%)	0.73	0.72	0.72	0.71	0.72	0.70	0.71	0.70	0.70	0.71	0.71
Rate of Natural Increase (%)	0.84	0.83	0.81	0.84	0.83	0.83	0.80	0.80	0.80	0.79	0.82
Immigration	149,400	114,900	86,300	112,100	143,100	128,600	121,100	89,200	88,200	84,300	111,720
Emigration	64,400	61,400	63,500	54,700	45,200	43,500	49,000	49,600	47,200	47,700	52,620
Net Migration	85,000	53,500	22,800	57,400	97,900	85,100	72,100	39,600	41,000	36,600	59,100
Net Migration Rate (%)	0.37	0.23	0.10	0.24	0.41	0.35	0.29	0.16	0.16	0.14	0.25
Total Annual Pop. Increase (1)	274,500	259,000	227,100	267,400	309,400	290,500	270,800	238,800	242,400	237,400	261,730
Residual (2)	-3,700	12,300	12,300	12,100	12,300	5,100	0	0	0	0	5,040
(%) Rate of Pop. Growth	1.20	1.12	0.97	1.13	1.29	1.20	1.10	0.95	0.96	0.93 (3)	1.09
% of Annual Growth from Natural Increase	70.4	74.6	84.5	74.0	64.4	69.0	73.4	83.4	83.0	84.5	76.1
% of Annual Growth from Net Migration	31.0	20.7	10.1	21.5	31.6	29.3	26.6	16.6	16.9	15.4	22.0
% of Annual Growth from Residual	-1.4	4.7	5.4	4.5	4.0	1.7	--	--	--	--	1.9
Total Fertility Rate	1.825	1.806	1.757	1.764	1.746	1.704	1.694	1.680	1.686	N/A	1.740

(1) Total Increase = $P_{x+1} - P_x$.
(2) Residual: Total annual population increase between the 1976 Census and the 1981 Census, minus the sum of (i) the Intercensal estimate of natural increase and (ii) the Intercensal estimate of net migration. The residual thus accounts for "closure error", which is the difference between the actual Census counts and the Intercensal estimate of total annual population increase for that five-year period.
(3) Pop. January 1, 1986 = 25,501,200.
* Final data from 1976 to 1984 and preliminary data for 1985.

Source: CEIC, Table on Basic Demographic Data for Canada, 1976-1985, By Calendar Year; reproduced in Seward, 1987, d, Table 2.

Table 8
Sources of Labour Force Growth
(average annual percent rates of growth)

	1951-1956	1956-1966	1966-1973	1973-1979	1979-1983
Source Population	2.1	2.2	2.6	2.3	1.7
- Net Immigration	1.0	0.5	0.4	0.4	0.3
- Domestic	1.1	1.7	2.2	1.9	1.4
Participation Rate	-0.1	0.4	0.7	1.0	0.3
Total Labour Force	2.1	2.6	3.3	3.3	2.1

Source: Library of Parliament (1986), Table 2, page 10; reproduced in Seward, 1987, d, Table 3.

Comments

Toru Yano

I am interested in the ultimate objective of population policy in Canada. It seems probable Canada's population will peak at 30 million at the turn of the century and, after that, population is likely to decrease. This is an interesting point, for it means that Canada will have to devise economic and political policies that are predicated on a limited population base in order to survive as a nation. Are there any proposals to try to increase the absolute number of people by means other than immigration?

We have heard that most of the immigrants coming to Canada are skilled workers and that their educational level tends to be higher than the average educational level of the Canadian population. My questions related to immigration are: What sort of occupational sectors do these immigrants join? What nations do immigrants currently come from? And from what parts of the world does Canada expect to attract future immigrants?

Shirley Seward

There is considerable debate about the "optimum" size of Canadian population. However, there appears to be an emerging consensus among demographers and economists that Canada should attempt to a least maintain its current population level. For that reason, immigration policy becomes important. Of course, the other tool for trying to maintain the population level is increasing fertility. Many countries in Europe have attempted to increase fertility through pro-natalist policies which include the provision of loans to families, a range of tax measures, the provision of family allowances and other measures. However, the record to date has not been encouraging. In Canada, some of these incentives are available but, at least until recently in the province of Quebec, have been provided as social policies designed to improve the welfare of families and children rather than as explicit pro-natalist measures. The reality is that fertility levels have been falling in Canada since the 1960s, and may well continue to fall.

On the relationship between immigrants and wage rates, theoretical literature suggests that immigration, by increasing the supply of labour, lowers wage rates. A number of empirical studies using Canadian macroeconomic models have found this to be the case. However, the effects are very small. Perhaps more important, a number of of criticisms have been made regarding the capacity of these models to assess fully the economic impact of immigration. Several of these criticisms suggest that the positive effects of immigration may have been underestimated. For example, most of the modelling studies do not take account of the human and financial capital associated with immigrant flows. Also the studies do not consider the possibility that immigrants may fill critical labour shortages, thereby relieving bottlenecks and stimulating employment.

Studies using the 1981 Census data show that a higher proportion of immigrant men compared to non-immigrant men are in managerial, professional and technical occupations. However, they are also over-represented in the relatively low-skill, low-

wage processing, machining, product-fabricating and assembling occupations. The presence of immigrant men at the top and the bottom of the occupational scale is also characteristic of immigrant women.

Regarding the origin of immigrants, traditionally a high proportion came from the United Kingdom and Europe. However, over the years there have been dramatic shifts as these traditional sources of immigrants have declined in importance, and increasing numbers of immigrants have come from the Third World. In 1986, over 40 per cent of immigrants came from Asia, and it is expected that the proportion of immigrants from developing countries will continue to increase.

Noriyuki Takayama

Canada receives quite a number of immigrants, but at the same time, don't you also have a high level of emigration? What is the age structure of these emigrants? Are they aged people or are you also losing young people?

My second question regarding Canadian immigration policy is whether you use any special policies to induce skilled workers to come to Canada or, conversely, suppress the immigration of unskilled workers?

Shirley Seward

Your question on emigration is very difficult to answer precisely because we have relatively poor information available on the socio-economic characteristics of emigrants from Canada. We do not have a system, such as we do for immigrants, that keeps records of such information with respect to emigrants. To complicate matters, there are several categories of emigrants. First, a number of immigrants to Canada return to their country after a relatively short or even a much longer stay in Canada. Second, a proportion of immigrants leaves Canada and goes to a third country, such as the United States. And third, emigrants also include Canadian-born individuals who decide to leave for short periods or on a permanent basis. Existing studies suggest that the age, education and other characteristics of emigrants vary according to the category of emigrant. However, more research is needed to provide a definitive answer to your questions. With respect to the magnitude of emigration, the federal government estimates that the current level of emigration is approximately 50,000 per year.

In response to your question on immigration policy, Canada has three classes of immigrants: Family Class; Convention Refugees and Designated Classes; and Independent Class. These classes reflect the social, humanitarian and economic objectives of Canadian immigration policy. At present, they account for approximately 50, 20 and 30 percent respectively of all immigrants. However, these proportions have changed over time and vary from year to year.

The economic objective of immigration policy is ensured by selecting Independent Class immigrants on the basis of a system which awards "points" for factors such as

education and skills. Within this class, there is a special program which encourages business immigrants to come to Canada.

Junnosuke Kishida

In Japan, although the baby boom lasted for only three years, it didn't entirely end with the completion of this period. There was a second wave of baby boomers which came after the first became adults. In the case of Canada, the first baby boom wave was very long, but I wonder if you have experienced a second wave of baby boomers?

Shirley Seward

The same trend is being witnessed in Canada at the present time. The baby boom generation, which was born between 1947 and 1966, consists of adults aged 22-41 in 1988. Since the baby boom generation includes large numbers of adults of child-bearing age, it is not surprising that we are witnessing a baby boom "echo". However, since fertility levels are low, this echo is not likely to be as large as the previous baby boom.

Yutaka Kosai

In Japan, we currently have a discussion going about the extent to which we should accept foreign workers. With the appreciation of the yen, many illegal immigrants have come to work in Japan with the hope of making a lot of money and then returning home. This has become a public policy problem. There are, however, several reasons why Japan should accept more foreign workers, albeit on a legal basis. The first is that, as Japanese corporations become more and more internationalized, foreign employees will become more effective. The second reason is that we have a shortage of labour, especially in the construction sector, and foreign workers can help ease this shortage. However, I think that to a great extent, this shortage will be filled by temporary foreign workers, who will spend some years in Japan but will not live there permanently. This will be similar to the guest worker arrangement in West Germany. I think that a major part of Japan's discussion on this matter will be whether this type of temporary arrangement for national economic policy is justifiable.

Shirley Seward

There has also been debate in Canada as to whether it is better to import the skills we need for short periods, or to bring people in on a permanent basis. In Canada we do have some temporary workers. For example, people from the Caribbean have come to Canada on a temporary basis to work in the agricultural sector, especially in Southern Ontario. This arrangement is useful, not only for Canada, but also for the sending countries, because the workers return home with their earnings in the form of foreign currency and

they may also remit a portion of their earnings while in Canada. However, in general, most Canadians have taken the view that, for demographic social and economic reasons, it is better to encourage permanent migration than the kind of guest worker program that has been utilized in West Germany. We feel that people will make a greater contribution if they settle in Canada, and if they are permitted, and encouraged, to bring their families with them.

Toshiaki Matsumoto

Last fall, a bill dealing with illegal immigration and detention was introduced into your House of Commons. I am very interested to know the present status of this bill.

In Japan, immigrants tend to come into the lower occupational classes whereas, in Canada, the immigrants tend to be more oriented to middle- or upper-classes. For those who do come to Canada at the bottom end of the scale, especially refugees, are there any human rights and social welfare issues? Until recently, Canada was seen to be a very progressive nation when it came to refugees, but some people now say that it has a negative position *vis-à-vis* these people. If this is so, what are the reasons for the change?

Shirley Seward

The bill that you are referring to is C-84 and its status has changed very rapidly recently. It has been passed by the House of Commons despite the fact that there was very great opposition to it from churches, immigrant groups, both opposition parties and the Senate. In fact, the Senate recommended many amendments to the bill, but the government accepted only a few. My view of the bill is that it is a regrettable, repressive over-reaction. I hope that if it becomes law it will never be used. There is another immigration bill called C-55 which is also under consideration. While there are some problems with this bill, it represents a reasonable attempt to improve the process of refugee determination in Canada. Hopefully, once it is in place, we will have a more effective system.

With respect to Canadian policy on refugees and our humanitarian stance, for decades Canada has set a very good example and has been recognized internationally for doing so. The problem that Canada, and indeed many other countries, is facing is that the rules of the game have changed. We used to be able to select the refugees that we wanted to bring to Canada but now, because it is easier for people to travel, they can arrive in Canada and other industrialized countries and seek asylum directly. We now have a different situation for which we need different policies. I think that we have an obligation to work with other receiving countries to decide how we can best respond to these changing international circumstances.

Global Economy/Domestic Society: Competing Challenges to Governance in Canada

Richard Simeon
Queen's University

I. Introduction

This paper* explores the implications for Canadian political institutions and political processes of two sets of challenges arising from changes in the larger context for Canadian governance. On one hand, the institutions of Canadian governance must respond to the effects of a changing global environment, in particular, to the increasing constraints arising from global interdependence, and to the need to ensure Canadian competitiveness and the ability of Canadian governments to project Canadian interests abroad. Canada is, as the economists say, a small, open, price-taking economy, heavily dependent on foreign trade, and existing in proximity to a dominant and culturally similar neighbor. How does such a country adapt its institutions and processes to the implications of these realities?

On the other hand, institutions and processes must also respond to a changing domestic society—a society characterized not only by demographic trends such as an aging population, but also, and more important, by the mobilization of new groups, and by the resulting changes in conceptions of the good society and of social justice.

Both sets of issues have posed major challenges to Canadian governance in the recent past, and will continue to do so in the future. In a sense they are complementary: both arise out of complex patterns of modernization and economic and social development. But, in another sense, they are profoundly in tension. One set of forces pushes us in the

* This paper draws deeply on my earlier work "Some Issues of Governance in Canada," (Langford and Brownsey, 1988: 267-312), in which full references will be found. I am most grateful for the assistance of Ms. Elaine Brien in the preparation of the earlier work, and for her comments and criticisms on this essay.

direction of economic efficiency, and the need for greater competitiveness. The other pushes us in the direction of a greater concern with equity, social justice and redistribution. One constrains governments; the other seeks more creative involvement of government. One seems to imply a necessary restriction on the forces of democracy, and a much greater concern with coordination and perhaps centralization; the other emphasizes increased pluralism, diversity, citizen participation and democracy.

The ideological and conceptual challenge, therefore, is to find a new synthesis of these conflicting values—a redefinition or reformulation of the post-war political formula captured in the slightly inaccurate phrase: the Keynesian welfare state. That model combined internationalist external policies, macroeconomic demand management, and the construction of an extensive welfare state. It was, in Canada as elsewhere, also a political accommodation among business, labour and government, which also embodied an accommodation among federal and provincial governments and the regional communities of Canada. It was associated with a massive growth in the size and scope of government. This post-war consensus, in Canada, as in other countries, unravelled in the 1970s, and has yet to be reconstructed.

These two sets of forces also challenge the pattern of Canadian politics derived from the past. Both challenge the historic Canadian preoccupation with regional and linguistic differences and call into question important aspects of Canada's relatively decentralized federal system, its parliamentary system, and its executive institutions. Thus, both sets of challenges relate directly to current debates in Canada about the role of the state, and its relations to citizens and economic interests. They raise important questions about the effectiveness and responsiveness of the three central "pillars" of the Canadian governing framework—federalism, parliamentarism and the judicial system. And they pose many questions for the efficacy and representativeness of executive and bureaucratic agencies.

Many of these issues have crystallized in the public debates about the two most important initiatives of the present Progressive Conservative government. One relates directly to the international side of the equation and the other to the domestic side. Both—if adopted—will shape Canadian governance for the foreseeable future. Both have engendered passionate debates about each of my central themes—the character of the Canadian political community, the effectiveness of governing institutions, and the quality of Canadian democracy.

The Canada-U.S. Free Trade Agreement (FTA) (Canada: 1987) is a response to the changing global environment—one which has potentially important implications for many aspects of domestic politics and governance within Canada, including federalism, regionalism, and the ability to respond to changing domestic forces. I will consider only its political implications—leaving the economic implications to others. The Meech Lake Accord—formally known as the "1987 Constitutional Accord"—is a constitutional agreement signed by the heads of the federal and ten provincial governments in June

1987.* It completes the constitutional renewal begun in 1982. Its critics argue that it reinforces a pattern of decentralized federalism and institutionalized regional and linguistic differences, which will inhibit future responses both to the requirements of more effective policy-making, and to the need to accommodate newly mobilized social forces. Thus, much of my discussion will draw on these two documents.

Let us look first at some of the implications of the changing global environment.

II. Global Challenges to Canadian Governance

The global challenges to all nation-states need not be explored fully here: I am more concerned with their implications for domestic governance and with the capacity of domestic institutions to meet them. These forces range all the way from the decline of American political and economic hegemony—of special importance since Canadians live under the American shadow; the rise of competition from the newly industrializing countries; the globalization and extraordinary fluidity of international capital markets; global interdependence arising from the spillovers of everything from acid rain to fiscal policies; the effects of technological change, especially in communications; and even the rapid international transmission of ideas.

Such forces are not new for Canada. Indeed, Canada has always been a country whose economic, social and even political development has been shaped by its relationship to a succession of dominant metropolitan powers—France, Britain, the United States; it is a cliche—but in sharp contrast to Japan—that Canada is a country of immigrants; Canada has always been highly dependent on foreign markets—especially in primary products—and has always had relatively high levels of foreign ownership within the domestic economy; Canada has always been a consumer of ideas, values and policy ideas from abroad. Hence we are talking about changes in the character of global forces, rather than the simple fact of interdependence.

Moreover, it is misleading to talk of Canadian interdependence with the rest of the world in a general sense: for in Canada, one foreign relationship dominates all others—that is the relationship with the United States. This is at once an economic, a social and a political relationship. The very sensitivity of Canadians about their need for cultural, economic and political independence of the United States is a reflection not of the distance between them but of the closeness, and the fear that even those small differences will disappear. The pervasive links are, of course, primarily a product of geographic contiguity. But they are also a function of policy, and since World War II Canadian economic integration with the U.S. has steadily increased. The Free Trade Agreement should be seen not as a revolution in Canadian economic relationships but as an incremental step in a larger process. Since World War II, Canadian policy has also

---

* Both agreements have generated a massive amount of commentary in Canada. For representative views on Meech Lake, see *Canadian Public Policy*, Special Issue, 1988 and Carole Rogerson and Katherine Swinton eds: 1988. For Free Trade, see Murray G. Smith and Frank Stone, eds: 1987; and Michael Henderson, ed.: 1987.

vacillated between this process of economic integration and efforts to safeguard Canadian independence.

At the most general level, the chief influence of these global pressures is that they simultaneously shape and define the issues with which Canadian political processes must deal, and constrain the responses they can make to them. For example, Canadian environmental issues are largely focussed on acid rain and Great Lakes pollution originating in the United States, and Canadian social movements, such as gender, take distinctive Canadian forms but often receive their impetus from developments elsewhere. To use a more concrete example, perhaps the single best explanation of the extraordinary period of regional conflict in the 1970s was the change in international energy prices; their more recent decline also helps explain the recent harmony within Canadian federalism. Thus domestic political conflict is best understood as the interaction of external forces with the existing cleavages and divisions within Canada's regionally differentiated society.

The constraints are equally important. Writers like Andrew Martin [in Banting, 1986: 157-242] have argued that it is becoming harder and harder for advanced industrial societies to maintain their commitments to the welfare state, high minimum wages, strict environmental controls and the like because of the increasing role played in international trade by countries which have much lower wages and lower standards. Global pressure, therefore, puts increasing pressure on "progressive" domestic social policies. Similarly, the mobility of capital and wealth places increasing constraints on progressive tax regimes. Other important levers of public policy have also become constrained: global and North American financial markets mean that a country such as Canada is less able to carry out an independent fiscal or monetary policy; the GATT has constrained the use of tariff policy—once the most potent lever of industrial policy—as an instrument for managing the domestic economy. This is not to argue against all such measures, but rather to argue that the "freedom of action" of all countries to pursue independent policies responsive to the play of domestic political forces has become more limited.

In Canada, these constraints are most often felt in the form of pressures from the U.S. for greater "harmonization" of policies in different areas. The mechanisms vary. Formal agreements, such as the FTA, embody a mutual agreement to limit policy in certain areas. Even without these constraints—which trigger some of the strongest objections to the agreement in Canada—a variety of Canadian regional development and industrial policies have been challenged under U.S. trade law as constituting unfair non-tariff barriers, or as unfair subsidies to Canadian producers. Many commentators argue that a more open North American market will create even more indirect pressures for harmonization, bringing Canadian policy more into line with U.S. practices. They fear, for example, that Canadian-based firms, faced with tough taxation, environmental or labour relations regimes in Canada, will increasingly be able to alter Canadian policy by threatening to relocate south of the border. This is a central reason why the Canadian labour movement is so strongly opposed to free trade: they fear it will greatly increase the bargaining power of capital *vis-à-vis* labour, especially since the U.S. labour movement is now so much weaker than its Canadian counterpart. While all these pressures for harmonization exist today—and might even increase in the absence of free trade—there is a widespread sense that the agreement represents a major step towards the

convergence of Canadian and American policy. Given the relative size of the two countries, this can only mean in the direction of U.S. standards.

Increased global and North American interdependence has other implications for domestic governance. It argues strongly for a policy mix which emphasizes economic efficiency over other goals, such as income redistribution, and thus strengthens the political influence of capital in relation to labour. It calls into question the post-war accommodation, which suggested that efficiency and the welfare state were compatible, or even mutually reinforcing. Now it is more common to see them as in tension. Global interdependence also suggests that mediating between the domestic and international environments has become an increasingly important role for governments. No longer can "domestic" and "foreign" policy be placed in different boxes; no longer can domestic policy-makers make decisions on social and other policies as if the rest of the world did not exist. This mediation role means that governments must become more concerned both with managing the impact of global developments on the domestic society—cushioning their effects, promoting adjustment—and with projecting domestic interests into the global arena more effectively. Finally, the pressing global environment suggests that there may be high costs associated with domestic fragmentation and diversity: a country which cannot coordinate its strengths and act in a united fashion abroad, it is argued, is less likely to be effective.

From this perspective, many would argue that Canada is less equipped for the international competition than it should be. At the societal level, the regionalized character of the Canadian economy means that some conflicts carried out at the international level are replicated in regional conflicts within Canada. Regional and linguistic divisions render consensus on a "national" policy difficult.

More important, the relatively decentralized Canadian federal system has been held to undermine the Canadian capacity to deal with global challenges. First is a "constitutional gap", identified by the Royal Commission on the Economic Union and Canada's Development Prospects (the Macdonald Commission), which reported in 1985 the absence in Canada of an agreed mechanism for treaty ratification and implementation. The 1867 Constitution did not contain an explicit treaty-making power since at the time it was understood that the British imperial government would retain control over Canadian foreign policy. As Canada came to assume an international personality, legal interpretations agreed that the federal government did indeed have the power to negotiate and sign treaties, and to act for Canada abroad. But the treaty power did not extend to the power to implement them. That power was to be limited by the constitutional division of powers between the federal and provincial governments: Ottawa had the unilateral right only to implement treaties which fell within its authority. That caused few problems so long as foreign policy dealt with security matters or, in the international field, was focussed on tariffs, which lie unequivocally within federal jurisdiction. The anomaly became more pressing when international trade arrangements came to focus on non-tariff barriers, since many provincial powers and provincial programs could be implicated.

The practical difficulties this involves were clearly demonstrated in the 1986 U.S. countervail actions against alleged subsidies to Canadian softwood lumber producers.

The challenged policies were provincial forest management and revenue-raising activities, since most Canadian forests are on provincial Crown land. It was thus extraordinarily difficult for Canada to formulate an effective response, since the divergent interests of federal and provincial governments had to be accommodated. This provincial role is also a major reason why U.S. free trade negotiators were insistent that any agreement must be binding on the provinces.

In the end, the trade agreement was carefully written to implicate as few provincial powers as possible. Nevertheless, finding an effective Canadian mechanism for dealing with such matters remains a pressing task. The Macdonald Commission's solution was to recommend a procedure for federal-provincial agreement on those aspects of international treaties touching on matters of provincial jurisdiction. Such a mechanism would place a heavy burden on intergovernmental consensus-building institutions, especially given intergovernmental rivalries, and divergent regional interests.

Another evolution is also possible. The constitution gives the federal government responsibility for interprovincial and international trade. These terms remain a grey area in Canada. But the general thrust of the courts has been to narrow the scope of federal power, at least partly to preserve economic room for the provinces. This evolution has been quite different from that in the United States, where the trade and commerce power has been the primary instrument for a sweeping assertion of federal authority over the states. In Canada, in the new circumstances, it remains distinctly possible that the courts could give a more expansive interpretation to "trade and commerce", finding that many provincial policies, such as liquor and wine purchasing, are in fact intrusions into interprovincial and international trade. If that happened, the balance of power in the federation could shift sharply—a dramatic example of the effects of global forces on domestic political institutions.

A final element of federalism and international relations is the conduct of international activities by provinces. Most provinces now maintain some form of representation abroad, and all conduct extensive trade promotion efforts. There is an extensive network of informal agreements between U.S. states and Canadian provinces. It is to be expected that this trend will continue. Especially under free trade, with decisions in Washington now even more critical for Canadian fortunes, one can imagine provinces finding it almost as important to lobby effectively there as in Ottawa. This would further fragment the unity of Canadian interests.

On the other side of the coin is the domestic capacity to pursue policies which help Canada adjust to the exigencies of global competition. As I have mentioned, one result of global interdependence is to reduce the weight and effectiveness of a number of federal policy instruments—notably fiscal and monetary policy and tariff policy. On the other hand, attention thus turns to a variety of microeconomic policies—education, labour-relations, land-use planning and the supply of amenities and services such as health care. These may be the most important policy instruments of the future. In Canada, they tend to fall largely into provincial jurisdiction. For example an OECD panel [In Meekison, ed.,1977: 416-429] was astonished to see how little role the federal government played in Canadian education policy, especially post-secondary education. How, it asked, was it

possible to run an effective modern economy with such a decentralized pattern? Thus, many would argue that the international imperative suggests the need for much greater coordination of such policies across provinces, or the assertion of a greater federal role.

But Canadian political forces suggest that only under the most extreme circumstances would it be possible to undertake centralizing constitutional amendments which would bring this about. The Meech Lake Accord responded to provincialist, rather than centralist pressures. While it did not involve any substantial devolution of power—except in the membership of the Senate and Supreme Court—nor did it involve any centralization. What it did was to underscore the extreme importance in the Canadian federal system of policy-making as a partnership among 11 co-equal governments. It constitutionally entrenched annual First Ministers' Conferences on the Economy and the Constitution, symbolically recognizing this conference as the pinnacle of a massive network of intergovernmental mechanisms.

Finally, it is argued that the combination of extensive provincial economic powers, combined with competing regional interests, has led provinces into undertaking their own economic development ("province-building") policies, which have had as one consequence the erection of numerous barriers to interprovincial trade. This in turn has been held to weaken Canadian international performance by challenging the advantages of regional specialization, and by forcing Canadian industries, such as brewing, to fragment across the country, thus inhibiting the development of efficient, large-scale firms. The fragmented state of the "Canadian Economic Union" has been an important feature of recent debates and ways have been sought, again largely by promoting intergovernmental agreement on "codes of conduct" to reduce these internal barriers.

Thus, one of the central questions for the future will be how to adapt our federalism, and the roles of federal and provincial governments, to meet the international situation. Some critics might liken this debate to a much earlier one, in the 1930s and 1940s. Then the question was whether Canadian federalism could adapt to the economic crisis of the Great Depression, and, whether federalism would prevent the emergence within Canada of the new roles in welfare and economic policy, which all modern states were called on to play. Federalism, Harold Laski wrote in the 1930s, (Laski: 1939) was simply obsolete, incapable of meeting new needs; some might argue the same now.

Others might argue that a relatively decentralized federalism in fact provides an especially flexible and adaptable set of instruments for responding to new challenges. In this view it is the federal government, hamstrung on one side by international constraints and on the other by the political need to balance numerous differing regional interests, which is incapable of developing and implementing coherent, consistent policies. Provinces, representing more homogeneous interests, may, on this analysis, be much more capable of developing such policies, and of experimenting with new policy alternatives.

Meeting the International Challenge

All modern governments face challenges similar to those Canadians face, and there is a variety of institutional and policy responses to them. Similarly, in Canada, there has been a vigorous debate about alternative strategies. These have tended to fall broadly into two categories: a market-oriented approach, which argues that the primary objective must be to ensure greater efficiency and competitiveness in Canadian industry, and that the best way to do so is to open the system to the unalloyed forces of domestic and global competition. The message is, adapt or die. The approach argues that most of the interventionist policies designed to promote economic growth have proved either ineffective or, worse, have contributed to inefficiency in the economy and delayed adaptation. The political prescription, therefore, is for reduced intervention, and for a social policy geared to serve economic efficiency ends. The Canada-U.S. Free Trade Agreement is the single most important manifestation of this approach in Canada. Indeed, for many of its supporters, its primary benefit is precisely that it will constitute a kind of voluntary strait-jacket, which will ensure that Canadian governments in the future will not be able to respond to political pressures to enact "irrational" economic policies.

The alternative approach, more reminiscent, in differing forms, of Sweden and Japan, might be called the corporatist interventionist approach. It accepts the challenge of international competition but, rather than simply rely on market forces for adaptation, it calls for a planned coordinated response, in which governments and leading economic interests of business and labour jointly agree on economic strategies. Elements of this model have many advocates in Canada, but it is most consistently put forward by the New Democratic Party.

This debate raises two sets of questions for Canadian governance. First, does Canada have the political and institutional conditions for developing either approach; and, second, what would be the implications for politics and governance if either were consistently applied?

As in other countries, business interests tend to line up solidly—at least in rhetoric—behind the market model. As we have seen, international capital also pushed strongly in that direction. The current federal government espouses the model and it is even more strongly advocated by a number of provincial governments. Nevertheless, there are a number of social forces ranged against it which, if not defeating it, may well ensure that this model will exist in very attenuated forms in Canada. Indeed, the caution of the Mulroney government in capping social security and unemployment insurance in the early years of its mandate, and the limited character of the free trade agreement it negotiated, is testimony to the fact that there is little "Thatcherite" single-mindedness in Canada.

Federalism itself is one reason for the attenuation of this model in Canada. Just as federalism did slow the development of the welfare state, so it can be argued that the complexities of federalism mean that it slows "radicalism" of the conservative variety. For example, it is a political imperative for any Canadian government to pursue regional development and redistribution policies. No Canadian government can afford to leave

whole sections of the country to the vagaries of the market. Moreover, whatever their ideological stripe, provincial governments are likely to resist federal attempts to reduce transfers or to trim social security spending, since this places additional burdens on provinces.

In many countries, labour is a major force opposing the market model. Canadian organized labour has historically been weaker than European trade unions, though much stronger than the U.S. movement. It has not become fully incorporated into the policy process. On the other hand, to the extent labour links with the other social movements discussed in the next section—such as women's movements and those concerned with cultural identity—the coalition against market models, and especially its free trade manifestation, gains considerable strength. Thus, two of the three federal opposition parties, as well as the government of Ontario, have opposed the trade agreement.

Major impediments also stand in the way of the corporatist interventionist model. There is a rich literature on the theme "why no corporatism in Canada". (Panitch: 1979) Most of it argues that a large number of societal factors stand in the way. Corporatist models seem to work best in countries which are highly homogeneous, socially and economically. Canada on the other hand is characterized by extreme heterogeneity: across regional, linguistic and other lines. Hence the interests which corporatist mechanisms would have to bridge and synthesize are highly diverse. They also work best where there exist strong, legitimate and highly inclusive groups representing the major interests. In Canada, not only is the organizational density of trade unions much less than in most European countries, but the movement is also fragmented and decentralized—by industry, by region, by language, and by "national" versus "international" unions. At the same time, the Canadian business class is relatively fragmented along many of the same lines, and its coherence is further weakened by the high degree of foreign ownership. Corporatist models also tend to be most common in countries where social-democratic parties are legitimate governing parties. This has not been the case in Canada, except at the provincial level.

The Canadian institutional framework also inhibits corporatist solutions. The logic and assumptions of majoritarian parliamentary government assume an adversarial, rather than power-sharing and consensual style of policy-making. More elaborate corporate mechanisms would also challenge the authority and accountability of legislatures.

Federalism also inhibits corporatism. Perhaps it is more accurate to say that federalism is itself a form of corporatism—one organized along territorial and inter-governmental rather than class or sectoral lines. With his emphasis on "national reconciliation" and federal-provincial collaboration, Prime Minister Mulroney has sought to re-emphasize this corporatist character. But to the extent that corporatism is organized this way, it may be difficult simultaneously to organize it along sectoral lines—though Germany tends to practice both models at once. Finally, federalism inhibits corporatism because the jurisdictional responsibilities which such a model would require are divided between the two orders of government.

Hence, just as it might be at the provincial level that the clearest expression of the market model may be found, it has been argued that the most likely location for the further elaboration of the corporatist/interventionist model in Canada may be the province.

Such models will continue to be debated. The current federal government has consulted extensively with business, as governments have in the past, but it is unlikely that Canadian governance will move much further towards the corporatist model. Certainly, enactment of a free trade agreement would place a further major hurdle before it.

This analysis suggests that the challenges of global interdependence raise a series of major challenges for Canadian political institutions. They pose fundamental choices with which it could be argued, the Canadian political system, preoccupied with federalism, is not well-equipped to deal with. These forces pose major challenges for federalism—and indeed could have major effects on federalism. They also pose challenges to other institutions, both those of parliament, and those of the bureaucracy. They will also have major effects on the balance of political forces—business and labour, region and region—within Canada.

They suggest a number of questions for research, and for policy-makers. First, it is important to explore much more fully the range of choices, or degrees of freedom, open to Canadian governments to make social and economic choices sought by their electorates. We need a better understanding of which levers can be pulled with effect, and which are no longer effective. We need both to discipline domestic policy-making with a greater sensitivity to the international implications of policy—and to seek within international constraints the largest degree of autonomy possible. We also need a much better understanding of the linkages between political institutions—parties, parliaments, federalism—and policy effectiveness. This is a linkage far more often asserted than demonstrated.

Finally, at a normative level, it is important for Canadians to seek to redefine for the next generation a "public philosophy" which plays the same role as the "historic compromise" of the post-war welfare state. Such a reformulation must take account of the changed global realities, but at the same time be sensitive to the maintenance of societal consensus. Thus, through whichever model, it is essential to adapt to global competitiveness, but such adaptation should ensure: a fair distribution of the costs and benefits of adaptation; the cushioning of the effects of change; and the broadest possible participation of citizens in making the necessary choices.

III. Domestic Challenges

But responding to international forces is only half the story. Challenges to governance also arise from the internal dynamics within the domestic society and economy; these too interact in complex ways with global forces. On one hand, there are the continuing,

traditional political divisions which have dominated Canadian politics since 1867, and which continue to structure political institutions and political debate. These are language and region. Then, there are newer forces, spawned by recent developments, which challenge the Canadian preoccupation with language and region, and which seek to re-orient Canadian politics on other dimensions.

Historically, it is the linguistic cleavage between French- and English-speaking Canadians which has most deeply divided the country, and which has had the potential to break it apart. In 1980, citizens of Quebec voted in a referendum on the question of whether Quebec should seek political sovereignty, followed by a looser, co-equal association with the rest of Canada—a referendum which brought to a head the Canadian constitutional crisis. The referendum lost, and with it died the most recent manifestation of Quebec nationalism, a nationalism which, unlike earlier manifestations, had been focussed on the Quebec state as the primary vehicle for the protection and growth of the French-speaking community.

This model—a Canada of two linguistic societies, one French-speaking centered in Quebec, one English-speaking and centered in the rest of Canada—has always been at one pole of the linguistic debate. It implies that Quebec, as a distinct society, requires a distinctive recognition and status within Confederation. In one form or another it has been the basic model followed by all Quebec governments in this century.

At the other pole has been a model which seeks to assure the equal status of French- and English-speaking Canadians across the country. It seeks to protect the rights of linguistic minorities whether they be English-speaking citizens of Quebec, or French- speaking citizens elsewhere. It also stresses the need to ensure that French-speaking Canadians are fully represented in the federal Parliament and public service.

The debate between these models was at the heart of the constitutional crisis. Each captures an important part of the social and political reality of the country. In the climactic struggles of the early 1980s the Quebec-centered model was defeated and a modest advance was made in the conception of Canada as representing minorities from sea to sea. The Quebec government refused to agree to this constitutional revision, and sought unsuccessfully to block it in the courts.

Many argued that, as a result, the constitutional settlement of 1982 was fatally flawed: how could it be legitimate if it could not be accepted by any Quebec government? If separatism now seemed to be in retreat, would not any future independence movement be able to build on the grievance of Quebec's exclusion?

Hence it was a central goal of the federal government elected in 1984 to find a way to "reconcile Quebec to the Constitution", to find a way for its government voluntarily to accept its terms. That necessarily meant at least some recognition of the idea of Quebec as a distinct society within Canada.

It is one of the great achievements of the Meech Lake Accord to have reached such an agreement, one which also recognizes the alternative model, and is consistent with another now entrenched principle—the juridical equality of the provinces. The Accord does this by specifying that, henceforth, the Constitution of Canada should be interpreted

in a manner consistent with a Canada which is made up of French- and English-Canadians who are present in all parts of Canada, and with the existence within Quebec of a distinct society. All governments are given the duty of "preserving" the dualist character of the country; Quebec has the additional duty of "promoting" its distinct society, though there is an explicit denial of special or additional powers. Quebec is also assured of a veto over all future constitutional amendments—a veto which is now shared by other provinces. Quebec is also assured that three of the nine judges of the Supreme Court of Canada will be from Quebec.

The Accord thus seeks to strike a balance between the contending conceptions of language and politics in Canada. It has been ratified by the federal House of Commons (though not by the federal Senate, which has a limited veto over constitutional change), by the Legislature of Quebec, and by all but two of the remaining provinces. Nevertheless, despite this settlement, and the decline of state-based nationalism, language will remain an explosive issue for Canadian governance. First, the Meech Lake settlement itself has been powerfully challenged. Even a symbolic recognition of Quebec as somehow special, with a distinct set of responsibilities to its citizens, former Prime Minister Pierre Trudeau has suggested, is a fatal first step towards separation. It legitimizes the idea that Quebecers have a distinct relationship with their provincial government, and begins to erode their ties to the federal government and to the larger Canadian community. Because "distinct society" is so ill-defined, it is argued it provides rich grounds for future conflict over interpretation. As recent events have demonstrated, the rights of minorities—whether anglophones in Quebec or francophones outside—is a divisive issue in several parts of the country.

Regional conflicts, often expressed as federal-provincial intergovernmental conflict, have constituted the other continuous thread of Canadian history. The decade of the 1970s witnessed perhaps the deepest period of regional conflict in Canadian history—driven by expansionist governments at both levels and, most importantly, by the changing terms of trade between resource producing and resource consuming regions. It too called the constitutional regime established in 1867 into question.

Regional conflict has become somewhat attenuated in the 1980s. In part this is because the conditions fuelling it had changed and because the Mulroney government's pledge of "national reconciliation" promised to restore inter-regional and intergovernmental harmony. The government was greatly assisted in this task by the fact that, in its massive victory, it was able to win broad support in all parts of the country and by the fact that most provincial governments were now of the same partisan stripe and broadly of the same ideological persuasion.

The poles in the debate about regionalism have paralleled those about language. On the one hand have been models which have emphasized the roles of provincial governments as the primary representatives of regional interests, and which have therefore sought to enhance provincial authority, protect provincial interests from the impositions of national majorities represented by the federal government, and assure that provincial governments played a role in national decision-making. On the other hand has been a view which sees the national, Canada-wide community as primary, and which has seen the national government as its chief expression. This approach has tended to argue

for the preservation of federal power, and has emphasized the need to assure that the federal government is effectively representative of all regions.

Again, these were central issues in the 1982 constitutional settlement, which incorporated a highly provincialist formula for amending the Constitution but effectively blocked any substantial growth in provincial authority. Moreover, it included a constitutional Charter of Rights and Freedoms, whose intent, and probable effect, was to give greater prominence to the rights of individuals over their governments, to the national dimensions of national identity, and to national institutions, notably the Supreme Court, as guarantors of these rights. Thus the 1982 Constitution Act was a limited response to the provincial demands articulated over the previous decade.

Another central goal of national reconciliation was to resolve this hangover. Thus the Meech Lake Accord is largely provincialist in orientation. It changes the constitutional-amending procedure to require unanimous provincial agreement on a larger number of issues, and to allow provinces to remove themselves from constitutional amendments restricting their powers, while receiving "fiscal compensation" from the federal government. It provides for a greater provincial presence in national institutions by permitting provinces to nominate members of the Senate and Supreme Court, from among whom the federal government must choose. And it constitutionalizes the notion of national policy-making through cooperative federalism, by providing for two First Ministers' Conferences a year.

Critics argue that the Meech Lake Accord, with its emphasis on protecting provincial interests, gives too little weight to national community, and too little opportunity for the national majority, acting through the national government, to impose its will. They suggest that the ability to opt out of constitutional changes and national shared-cost programs leads to the danger of a balkanized Canada, and to a federal reluctance to attempt national leadership.

In fact, Meech Lake appears to represent little change in the status quo. Large federal powers are left untouched and no new jurisdiction flows to the provinces. The Meech Lake framework could be a vehicle for both cooperative and competitive relationships among governments. Nevertheless, the debate illustrates how deeply divided Canadians remain about some fundamental features of their political community and political institutions. These debates are not likely to fade.

Nor should it be assumed that the recent waning of interprovincial conflict is permanent. The intensity of such conflict has varied over Canadian history: increasing when the issues facing the country have divided it regionally, decreasing when the issues which mobilized the population have cut across region. There are indeed possible grounds for a revival of inter-regional conflict in the increasing global pressures. The Free Trade Agreement may also have implications for regional conflict. In the short run, as the government and the Macdonald Commission have emphasized, the agreement tends to reduce regional conflict. By officially signing the death warrant of the so-called National Policy, which sought to build a Canadian economy on a regional division of labour in

which central Canadian manufacturing, financial and transportation interests were dominant, the Agreement removes an historic source of regional grievance.

However, the long-run effects of the Free Trade Agreement—and of market-oriented international forces generally—are much less clear. There is a distinct possibility that the costs and benefits will be unequally distributed regionally, thus providing fuel for a future politic of jealousy. Market forces may eventually reduce the ability of the federal government to alleviate such effects by policies of regional development and regional distribution. More important, the logic of the agreement is to end any notion of constructing an integrated economy along east-west lines. There will be no incentive for Canadians to trade with one another. It is a real question whether, in such circumstances, the national commitment to regional redistribution and regional sharing will be maintained. Just as Meech Lake does, free trade assumes that the best way of ensuring Canadians get along with each other is to disengage them and to provide guarantees that each region will be protected from imposition of the others' interests. Both agreements give less weight to the search for common themes and values which transcend region.

Thus, both region and language will remain challenges for Canadian governance in the future.

Meech Lake has been challenged not only by the centralists, who object to the conception of federalism it embodies, but by another set of groups, making a quite different critique. These are identities and interests not captured by region and language. They are a result of what Alan Cairns calls the "politicization of society". [In Banting, 1986] By far the most important, in terms of the long-run challenges to previously dominant practices, is the politics of gender and the mobilization of the feminist movement. Broadly associated are a host of other movements, all of which tend to focus on different aspects of giving voices and identities to previously quiescent groups, and all of which tend to articulate their concerns in terms of individual and collective rights. They include Canada's aboriginal peoples, and their search for some measure of self-government in the Canadian federation, the handicapped, homosexuals, and so on.

The primary political instrument around which they have focussed their concerns is the Charter of Rights and Freedoms adopted in 1982. It created a "third pillar" for the Canadian institutional structure—one which now exists in considerable tension both with the logic of parliamentary government (which emphasizes the will of majorities) and with the logic of federalism (which emphasizes territorial interests, and the authority of governments). The Charter has injected into Canadian politics a powerful instrument for the articulation of the rights of citizens against governments and legitimated a great number of new individual and group claims. Some see in the Charter a fundamental change in Canadian political culture and styles of action. Indeed, working out the relationships among federalism, parliamentarism and the Charter will be a major task for the political system, in the next period.

The challenge to federalism is manifest again in the debate about Meech Lake, which has been most effectively led by the women's movement. They argue that the constitutional commitment to Quebec as a distinct society may possibly undermine

important aspects of the Charter of Rights. They suggest that provisions providing some limits on the power to spend in areas of provincial jurisdiction may weaken the ability or inclination of the federal government to engage in progressive social legislation. They argue that, in dealing with the problems of federalism, region and language, there is no recognition by Meech Lake of the alternative conceptions of community they represent—no advance for women's rights, for multiculturalism, for aboriginal rights. Far from tempering the impact of the 1982 Charter, a new constitutional revision should extend it and remove some of the restrictions on it which were included in that document.

Finally, these groups mount a basic challenge to the political process by which the Meech Lake Accord was achieved. It was a classic case of the pattern of decision-making through federal-provincial agreement—known in Canada as "executive federalism". It is overwhelmingly a pattern of "elite accommodation", in which 11 first ministers met in private to negotiate a deal. Then, once the deal was made, it needed to be ratified by the 11 legislatures. But this debate was to be constrained by the fact that it could not be altered by them; any attempt to do so would unravel the delicate consensus and destroy the Accord.

Such a procedure, the critics argue, does not meet emerging standards of democratic practice. Crucial interests were not represented at the table. There was too little opportunity for public discussion and citizen participation.

Underlying all these criticisms is a powerful challenge to Canadian governance. First, implicit in the criticism is the view that region and language should no longer be the central defining interests shaping Canadian politics; much greater recognition must be given to alternative views. This "displacement thesis"—the view that territorial divisions were obsolete and atavistic—has been argued before. Several writers in the 1950s argued that, in a modern industrial society, social class was the fundamental division and that it was necessary to redefine Canadian politics around the "creative" politics of class. [Porter, 1965; Horowitz, 1968] Such predictions and prescriptions proved unavailing: the Canadian experience was not that the traditional divisions were replaced, but they became woven with the newer ones. Federalism shaped and constrained the emergence of class politics; but class politics—and the associated policy agenda—also shaped federalism. The same is likely to occur again. There will be no disappearance of earlier divisions, but new divisions will become expressed through the interstices of the federal system, influencing politics at both the federal and provincial levels.

Federalism is not the only political institution challenged by the newer groups. They also challenge the representativeness and responsiveness of bureaucracy, as in the search for greater gender equity in the public service, and they challenge representative, majoritarian parliamentary democracy—in their concern with individual rights expressed through the Charter and with the insistence on more participatory styles of decision-making.

Thus the domestic institutional challenge is to find ways to respond to these emergent demands, and to work through the increasing tensions between the logic of federalism, parliamentary government and the Charter, as well as between the

rationalistic, hierarchical, technocratic assumptions of bureaucratic government and the participant orientations of a more politically mobilized society.

IV. Conclusion

Each set of challenges—domestic and international—is complex and difficult in itself. Taken together they represent a powerful brew. They tend, as I said at the outset, to push in different directions. At root, the domestic pressures are for an enrichment and enhancement of political democracy. The kind of federalism found in the Meech Lake Accord—which, to some extent at least, disperses authority in the federal system more widely—and the claims made by the new groups, both suggest that the directions for change in the domestic polity are towards decentralization, greater pluralism, more widely shared authority, and greater concerns with social equity and social justice. Armed with the Charter, citizens are now powerfully equipped to advance these claims.

At the same time the exigencies of the international environment in many respects seem to call for just the reverse: for more centralized, controlled government, for more unity, for decisiveness and authoritativeness, and for limited political interventions into economic "rationality". Working out this contradiction, and exploring its implications for the role of government, the division of responsibilities between federal and provincial government, and the practice of parliamentary government, will be the task for the next generation.

References

Cairns, Alan. 1986. "The Embedded State: State-Society Relations in Canada." In Keith Banting, ed. *State and Society: Canada in Comparative Perspective*. (Toronto: University of Toronto Press). Research Studies of the Royal Commission on the Economic Union, Vol. 31.

Canada. 1985. Royal Commission on the Economic Union and Canada's Development Prospects. *Report*. Three Vols. (Ottawa: Supply and Services Canada).

Canada. 1987. Special Joint Committee of the Senate and House of Commons. *Report: the 1987 Constitutional Accord*. (Ottawa: Supply and Services).

Canada. 1987. *The Canada-U.S. Trade Agreement. Trade: Securing Canada's Future*. (Ottawa: Supply and Services).

Canadian Public Policy. 1988. Special Issue on the Meech Lake Accord. Summer, 1988.

Henderson, Michael, ed. 1987. *The Future on the Table.* (North York, Ontario: Masterpress).

Horowitz, Gad. 1968. "Toward the Democratic Class Struggle." in Trevor Lloyd and Jack McLeod, eds. *Agenda 1970: Proposals for a Creative Politics.* (Toronto: University of Toronto Press).

Langford, John W. and K. Lorne Brownsey, eds. 1988. *The Changing Shape of Government in the Asia-Pacific Region.* (Halifax: Institute for Research on Public Policy).

Martin, Andrew. 1986. "The Politics of Employment and Welfare." in Keith Banting, ed. *The State and Economic Interests.* (Toronto: University of Toronto Press). Research Studies of the Royal Commission on the Economic Union, Vol. 25.

Panitch, Leo. 1979. "Corporatism in Canada." *Studies in Political Economy.* 1979. 43-92.

Porter, John. 1965. *The Vertical Mosaic.* (Toronto: University of Toronto Press).

Rogers, Carole and Katherine Swinton, eds. 1988. *Competing Constitutional Visions.* (Toronto: Carswell).

Smith, Murray and Frank Stone, eds. 1987. *Assessing the Canada-U.S. Free Trade Agreement.* (Halifax: Institute for Research on Public Policy).

Comments

Rod Dobell

There was reference made yesterday to some of the puzzles posed to outside observers in examining Canada's federal structure. I am struck by the thought that in this area we pose rather a significant contrast to Japan in that, given our history and makeup, external challenges generate regional and social conflicts and disputes and alternative responses. One has the impression that, in Japan, external pressures generate a more coherent internal response. In another respect, Canada might be illustrating some issues yet to be addressed in Japan. In a sense, our community, with its many different groups and interests, will create, early in the process, pressures for a new social agenda, with new goals. These may represent demands to which the Japanese society will have to respond in the coming years. We may have, in a sense, illustrated the kinds of differing social interests that will have to be accommodated.

Mikiko Iwasaki

You said that federal/provincial conferences are an important mechanism for carrying out coordination between the two levels of government, but what is their legitimacy? Is it

backed by the constitution? If there is no legitimate legal basis for these conferences, are they not really just coordinating and consultation processes as opposed to decision-making mechanisms?

Secondly, I think that there has been a discussion about reforming the Canadian Senate. Is this push for reform getting stronger?

Finally, I am interested in decentralization theory. It seems that decentralization and democracy are harmonious combinations within a country. That is, decentralization can effectively reflect minority opinion and guarantee a coordinated and harmonious relationship. However, when you observe the presence of external threats to a country, probably decentralization is not an effective way to respond. By contrast, Japan has a unitary system in which centralized forces can effectively respond to external challenges. My question is, how does Canada coordinate challenges from both domestic and external sources?

Richard Simeon

You touch a Canadian nerve when you ask about the legitimacy of federal/provincial conferences. One of the most powerful criticisms levelled against the Meech Lake Accord is that it was a deal which the 11 heads of government negotiated in an all-night meeting, with very little consultation with the populations they represent. Although under our constitutional amending procedure the Accord must be ratified by all 11 parliaments, (so there is that kind of democratic ratification), the deal was so carefully worked out among the governments that if any one of them changes it the whole thing falls apart. It has been a great frustration to commentators that governments are not able to make changes or amendments to the Accord and that very much represents a challenge to its legitimacy and, more generally, of the process.

You are right to say that the federal/provincial conference has no constitutional status and it is not mentioned in our Constitution. However it will be, if the Meech Lake Accord goes through. The Accord says that there will be a First Minister's Conference on the economy and another one on the constitution every year. This will be the first time this mechanism has been mentioned in the constitution.

Furthermore, the Meech Lake Accord creates a requirement for additional coordination between governments. In the future, the provinces will nominate candidates for the Senate and the Supreme Court and the federal government will choose from among these candidates. Therefore, for these two very important institutions, appointments will be made jointly by the two orders of government. So, the Meech Lake Accord does a lot to further institutionalize the process of executive federalism.

One of our real dilemmas is how we reconcile a federal system in which the complexity and interdependence of federal and provincial policy means that you must have some degree of coordination among the two levels of government. At the same time, each is a parliamentary government, responsible to its own legislature. This creates a deep tension in our system. One way around it would be to recognize that only in very

limited cases will the First Minister's Conference be a decision-making or a policy-making body. More often it will be a body for general debate and consultation, with each government developing its own follow-up legislation. Or, at the official level, it would be devoted much more to bureaucratic coordination.

One of the assumed purposes of the Senate is that it would be the body in the national government which would represent the interests of the regions and the provinces. It has never worked that way because the federal government has appointed the members of the Senate and the appointees did not necessarily have legitimacy in the regions. With the greater regional conflict of the 1970s, more and more people began to say that the way to respond to these grievances might not be to give more power to the provinces, but rather, to make the federal government more representative of the regions, and that one way to do this was to reform the Senate. There have been various proposals to elect the Senate and to do so in some way to ensure that members reflect, and are spokespersons for, their provincial interests. It is not clear that enough of a coalition exists to support this type of proposal. Under our present constitutional-amending formula, it would require unanimity of all governments. Provinces on a whole don't like Senate reform because they like to see themselves as the representative of the region and they don't want competitors for that role in Ottawa. But there is one very interesting change in the coalition for Senate reform and that is that it is now Western Canada, especially Alberta, which is the region pushing hardest for it. Alberta is calling for a "Triple E Senate"—one in which the Senate would be elected, with each province having an equal number of members, and the institution having truly effective power. I think that the reason the west is seeking this, when only a few years ago it was seeking greater provincial powers, is a result of changing oil prices. During the 1970s, western provinces wanted more autonomy from the centre to use all that wealth for their own purposes. Their whole constitutional purpose was to write rules to prevent the national government from taking their oil wealth. Now, with the West on the skids, relatively speaking, as a result of fallen energy prices, the problem is not how to get more power for the provinces—because that is not worth so much any more. Instead they ask, how can we make sure that we have power in Ottawa? In other words, how can we temper the majority in central Canada by building into the central government greater weight for the provinces?

As for centralization and decentralization, Canadians have debated this aspect of democratic theory very much. However, there is a third model of democracy which has become exceptionally important in Canada and that is the kind built around individuals making appeals on the basis of individual rights. With the constitutional reform of 1982, Canada got for the first time a constitutional Charter of Rights similar, but much longer and more detailed, than the American Charter. This has proven to be a powerful weapon for citizens against governments. The model of democracy most often debated in Canada now is the individualistic, rights-oriented model of democracy, using challenges to the courts and the Charter of Rights. If there is a tension between federalism and parliamentary government, there is also a tension between parliamentary rights and federalism, on the one hand, and the new politics of the Charter of Rights on the other.

As for policy effectiveness, if one has a view of Canada as a single entity, for which one would seek to find a national interest, then one would argue in a centralist direction. It seems to me that one of the implications of free trade is to say that we have given up on

that idea—in other words, we don't have a conception any more of a single national economic interest in this country. If that is the case, decentralization follows naturally. But, I am sure that some of my colleagues would disagree.

Junnosuke Kishida

As I was listening to your presentation I felt envious of the structure of your country. Of course, I understand that you have some very difficult problems, but still I feel envy. You have a very powerful neighbour, but a political structure that can effectively cope with a strong neighbour is federalism, with the flexible independent provinces such as Canada has. You said that Canada will have some difficulty coping with external pressures, but probably this is not always the case. When there is some external imperative, Canada has a structure that is strong against such pressure.

In the case of Japan, we have the Liberal Democratic Party, which has enjoyed a long period of power and, in fact, the administration is the LDP itself. When the LDP is negotiating with foreign countries, it will frequently say to the foreign delegation that the proposal has to be modified in order to persuade the opposition party within the country. I have been involved in such negotiations many times with other countries. The LDP uses the opposition parties as a pretext for seeking changes in a negotiating process. Probably the same model can be applied to Canada. When you have this internal conflict between the federal and provincial levels, this can effectively cope with external pressure in the same manner as the relationship between the LDP and the opposition parties. Thus, I suggest that your political structure is largely positive when it comes to coping with external pressure exerted by a strong neighbour.

Richard Simeon

What you have said is very much at the heart of the debate. My own view would be that every country has its own institutional "givens" and we are not going to stop Canada from being a federal country. So it seems to me that the reform question is not, should we get rid of federalism? but rather, how do we build on it? I agree with you that there is a lot of resilience and strength in a relatively decentralized system. The task is to identify where the weaknesses are and try and build the mechanisms to deal with them. Back in the 1930s, the great British political scientist, Harold Laski, said that federalism is an obsolete system in light of the crisis of the Depression and the new roles of the state. Well, the Canadian story has been that federalism has affected how we developed these new rules of government (slowing development in some respects and speeding it up in others), but the point is, that we were able to adapt our federal system to play those roles. It seems to me that that is exactly how we should pose the question today. How do we adapt our federalism, both to these external requirements and with respect to the new social forces?

Toru Yano

In the 1970s, the word "governability" came into the picture. Usually it means efficient policy-making and implementation, a clear cut system of accountability and a rational ability to respond to issues. That is the general definition. But empirically what determines governability is not institutions or systems. Probably the existence or non-existence of governability is just accidental. We cannot say that a dictatorial system has a high degree of governability, for sometimes a dictatorship looses governability. Similarly, we we cannot always associate federalism with governability or democracy because they do not always come together. So we have to discuss more thoroughly what governability is all about.

Canada has a federal state and decision-making is very difficult given such a complex system. In contrast, it is often stated that Japan is a homogeneous nation in which the top-down system works to easily create consensus. But, this is a stereotyped analysis. We cannot categorically say that in Japan decisions are made quickly within a harmonious, consensus-based system. In Japan there are a lot of variables. If I were to choose a term to describe our system, probably "modular" would be most appropriate. As these modules are arbitrary in their movement, I sometimes feel that Japan is a more difficult country to govern than Canada.

Richard Simeon

I very much agree with your statements. If you take the crisis of governability, which all western countries were talking about in the mid-1970s, that crisis arose in countries with many different institutional forms and it was clear that, in so far that there was a crisis of governability, it arose out of social and economic changes and not out of institutional forms *per se*. It seems to me that institutions are a kind of second-order factor. This is not to say they are unimportant. Our particular institutional structure of federalism meant that we experienced that 1970s crisis of governability as a crisis of federalism, just as the Americans experienced it in terms of congressional/presidential relations, and the British a challenge arising from the power of organized trade unions and their ability to challenge governments. In these cases, the institutions shaped the form the crisis took and perhaps influenced its timing, but they didn't define the crisis itself.

Atsushi Shimokobe

In Canadian federalism, it seems that each of the ten provinces has a different way of thinking, and probably nationality and the national border is not always of great importance to these provinces. In China, the USSR and Japan itself, a similar discussion often takes place when we talk about national sovereignty. What I am saying is that the theory of the nation state is gradually being brought into question. So, from the standpoint of the theory of the nation, what would you say about federalism?

Richard Simeon

We often think about Canadian federalism in two different ways. When we have debated our regional conflicts we sometimes see federalism as contributing to a disintegrative process, moving from a relatively united into a less-united model. But obviously in many places where federalism has been introduced it has been a nation-building process. Another point is that the parallels between Canada's federal system and the European Community (a group of nominally independent nations associated in a common market) means that the distinction between sets of institutions that are federal within country becomes less and less important and that maybe the trend will be for us to be playing with a much greater variety of institutional forms in the world. On the one hand, we will be building more and more supranational institutions—as we have seen in the dynamic of development in the EC where the mechanisms started out as purely executive processes and now there is an elected European parliament—while, at the same time, there are forces leading to many more smaller institutions, and local governments, which are becoming more important in the system. It is conceivable the traditional nation state, which is beset by international forces which limit its effective autonomy, however sovereign it is legally, is perhaps the institution that is declining in comparison to both the ones above and the ones below it.

Atsushi Shimokobe

I am reminded of another issue that Canada faces, that of immigration. Although one has a nationality, individual personal rights suggest that one may live anywhere one chooses, either in the country where one was born or elsewhere. But, as we see in the present world, when one wants to exercise these rights and live anywhere in the world then the old nation state may be embarrassed and oppose this movement and represent it as a "refugee problem". Isn't this the case?

Richard Simeon

A very interesting idea. With respect to federalism and immigration within Canada, Canadian citizens do have the right to live anywhere in the country. However, there are many people from other countries who do come to live in Canada and this presents some very important challenges for our political process. The changing ethnic composition of Canada is affecting the way we debate language for example. More and more people are saying we are not of French or British background and that the system, with respect to language rights and the provision of services, should respond to our particular characteristics. You also begin to find much greater ethnic variation across the country. The large number of Asians who have come to Canada creates challenges to the existing patterns, which have institutionalized our historic division, and needs for very varied policy responses in such areas as education.

Sustainable Economic Development

Jim MacNeill
Institute for Research on Public Policy

Japan is a pioneer in environmental management. Since 1970, it has allocated a higher proportion of its GNP to restoring its environment and resource base than any other country. It has also played a welcome and increasingly important role in international environmental issues, especially since 1981 when the Reagan Administration reversed the traditional leadership role of the United States.

"Our Common Future", the global enquiry into the critical issues of environment and development, completed last year by the Brundtland Commission, was a direct result of this leadership.[1] The Government of Japan, along with the Government of Canada, led in the efforts to establish the Commission. The two governments also provided much of the financial support needed for the Commission's work, together contributing nearly $3.0 million of its total budget of $8.0 million. Dr. Saburo Okita, the world economist and environmentalist and ex-Foreign Minister of Japan, was a distinguished member of the Commission.

The Commission reached agreement on the text of "Our Common Future" in Tokyo, just 15 months ago, when it issued the Tokyo Declaration on Sustainable Development in the presence of Prime Minister Nakasone and other top Japanese leaders. The Tokyo Declaration stressed that the challenge to sustain world economic development, while retaining the essential ecological integrity of planetary systems, is greater today than it has ever been.

A population of five billion may double again within less than four decades and could reach 14 billion before leveling off within a century. Growth on the scale required to meet the needs and aspirations of this human family will entail a rapid expansion of

the world economy—perhaps five- to tenfold on the present base over the next half-century. If such growth is not sustainable, both ecologically and economically, if it rests on a continuing drawdown of the Earth's basic ecological capital, it will undermine itself and threaten the survival of a large part of humankind.

The Commission's report identified many current economic, trade, energy, agricultural, development assistance and other policies, that are at the source of an accelerating drawdown of the planet's environmental resource capital. They are reducing, not increasing, the potential for future development and, in many areas, they are threatening survival. They are not sustainable.

"Our Common Future" calls for a rapid transition to more sustainable forms of development. A fundamental reorientation of the institutions and modes of decision-making behind many current policies is required. In particular, our central financial, economic and trade institutions, and the major sectoral agencies, national and international, must now be made responsible for ensuring that their policies are ecologically as well as economically sustainable, and they must be held accountable for it in various ways.

The Commission

The Commission had started its work in Geneva 900 days before its final meeting in Tokyo. There were 22 Commissioners in all—political leaders, industrialists and scientists—from every region of the globe, with a majority from developing countries. Mrs. Gro Harlem Brundtland, Prime Minister of Norway, was Chairman of the Commission, and Dr. Mansour Khalid, one time foreign minister of the Sudan, was Vice Chairman. I became Secretary General.

We went through a broad process of analysis, learning and debate. We did all of the normal things a commission is suppose to do. We contracted papers, established panels, invited distinguished world figures to meet with us, and so on.

But we did something else that no previous international commission has attempted. We organized open public hearings in every region of the world, from Jakarta to Moscow, Sao Paulo to Oslo, Ottawa to Harare.

The Commissioners represented every shade of political ideology and personal commitment in today's world, and we went down to the wire on a number of issues such as energy, for example. The emotions surrounding nuclear energy were reinforced by "the Chernobyl effect", and several attempts at consensus were resisted. Population, Antarctica, international economic relations and institutional reform proved almost equally difficult. But in the end, we had a consensus on the issues, on the imperative need to shift to more sustainable forms of economic development, and on certain directions for change in our policies and institutions to enable us to manage both the growing risks and the immense opportunities facing the world community.

That consensus, politically the most important characteristic of our report, was largely made possible by two factors. First, the process of open public hearings. They enabled us to meet and take evidence from thousands of people—from farm workers to presidents, from indigenous peoples and slum dwellers to industrial leaders, and from local activists to the world's most prestigious learned societies. They gave us a set of shared experiences and a common information base. The second was a compelling sense of the urgency of the issues, which grew over the 900 days of our work.

The Great Transition

During our work, the Commission heard from many scientists who argued, from various perspectives, that we are now living through a great transition in the relationships between the human world and the earth's biosphere, in the relationships between economy and ecology. The two have become interlocked irreversibly and, today, to ignore the one is to jeopardize the other.

One measure of this transition is economic activity. We are now in a $13 trillion dollar economy. Economic activity has increased more than 20-fold since 1900. The use of fossil fuels has grown by a factor of 30; industrial production by a factor of 50. And, four-fifths of all this growth has taken place in since 1950.

Another measure is equity. This economic activity has been concentrated in the industrial countries. With one-quarter—soon 20 percent—of the world's population, they consume about 80 percent of the world's goods. That leaves three-quarters of the world's population with less than one-quarter of its wealth—an imbalance that has been getting worse, not better, and one that cannot be allowed to endure.

A third measure is the demographic momentum. The world is now rushing towards a population of somewhere between 8 and 14 billion next century. Almost as many new people will be added to the Earth in the last 5000 days of this century as existed in total at the beginning of it. Over 90 million will be added in this year 1988. Most of these children will be added to desperately poor families in the Third World.

In spite of increasing affluence and well-being in many developing countries, over 800 million of their people live in absolute destitution. Pervasive poverty is both a cause and effect of massive environmental destruction. It is perhaps the greatest threat to the ecological basis of future development and a central problem that the Commission had to address.

A fourth measure of the transition is what the Commission called the growth imperative. Development at historically unprecedented rates will be needed in order to meet the needs and aspirations of present and future generations. A five- to ten-fold increase in economic activity would be needed over the next half century to raise consumption in developing countries to more equitable levels. Energy use alone would have to increase by a factor of eight to bring developing countries, with their present

populations, up to the level now prevailing in the industrial world. Similar factors could be cited for food, water, shelter, and the other essentials of life.

A five- to ten-fold increase in economic activity over the next half century translates into a colossal new burden on the biosphere. This growth will not occur if it rests on a continuing drawdown of the Earth's basic capital of environmental resources.

The Earth's forest cover is an example of this. Forty years ago, Ethiopia had a 30 percent forest cover; 12 years ago, it was down to 4 percent; today, it may be 1 percent. Seventy five years ago, India's forests covered over half the country. Today, they are down to 14 percent—and going fast. In the tropics today, ten trees are being cut for every one planted—in Africa, the ratio is 29 to 1. The Earth's forest cover is disappearing at a rate equal to the size of the United Kingdom every year.

One result is the mass extinction of species now underway. Tropical forests are inordinately rich in plant and animal species. The Smithsonian Institution's Tropical Research Institute has determined that one square kilometer of one rain forest in one small country—Panama—contains more species than all of Britain. The extinction of these species not only deprives us of yet undiscovered medicines and foods but also dangerously reduces the genetic base upon which modern agriculture depends. Almost all of the food crops in the developed world—wheat, corn, soybeans, sorghum and rice—are derived from genetic stock from Africa, Asia and Latin America. Our ability to cross breed for increased yields, resistance to pests and disease is threatened by a reduction in this diversity.

Another result is widespread soil erosion and advancing deserts. An area larger than the African continent, and inhabited by more than one billion people, is now at risk from desertification and every year this area grows by six million hectares. The consequences include not only increased hunger and death but also social instability and conflict as dryland degradation drives environmental refugees in their millions across national borders.

Many countries in Africa, Asia and Latin America are today in deeper ecological debt than financial debt. But even the richer industrialized countries can no longer keep up with the pace of change. A mounting tide of toxic substances continues to enter the atmosphere, the waters, the soil and the food chain. Between 1000 and 2000 new chemicals will enter the market place this year alone, most of them without adequate prior testing. Acidification continues to accumulate in the environment. The ozone layer is threatened and man-made climate change is a looming prospect. The industrialized nations are falling behind on just about every front.

It is sometimes argued that Canadians don't have to worry too much about these trends because the Canadian environmental resource base is so large in relation to Canada's population and economy. Just recently, for example, in the context of a discussion on global warming, I heard it argued that, because the North American grainbelt may move northwest into the Prairies and the Yukon over the next three decades, with rising mean temperatures, Canada will be a winner, not a loser, in the climate change stakes.

This is an all too common example of superimposing 19th century concepts on 21st century realities. The fact is that in today's world, Canada's environmental resource stocks are not held in separate capital accounts marked "Canadian". They are held increasingly in joint accounts with the rest of the world, including Japan. And if these joint accounts bear any name, that name is "interdependence", economic and ecological.

The proposed trade agreement with the U.S. will enhance the joint nature of North American environmental resource accounts but, in fact, through the market economy and the global trading system, any nation, company or individual with the currency power can and will increasingly draw upon environmental resource capital located in Canada for their well being. And conversely, of course, Canadians will do the same.

Sustainable Development

Sustainable development is the over-riding political concept of "Our Common Future". We define it in ethical, social and political terms. Most simply, we refer to it as new paths of progress "which meets the needs and aspirations of the present generation without compromising the ability of future generations to meet their own needs."

Sustainable development requires that we live off the Earth's interest, without encroaching on its capital. It also requires investing to sustain and even enhance that capital, so that future dividends can be ensured and enlarged.

Growth alone is not enough. Sustainable development requires strong measures to change both the content and the quality of growth and equally strong measures to ensure a more equitable distribution of the proceeds of growth, nationally and internationally. The Commission believes that a new era of growth is possible—so long as it is based on economic processes that are less material and energy intensive, that enhance rather than degrade the resource base, and that encourage processes that maintain the stock of ecological capital without treating the environment as a fixed asset.

Sustainable development is a new concept for economic growth. It goes far beyond sustainability in the environmental sense. It is a broad concept for social and economic progress that has the potential to provide new insights for institutional reform and inspiration for international cooperation.

The Transition to Sustainable Development

Although the concept of sustainable development needs to be fleshed out by economists, ecologists, politicians and others, it has caught the eye of governments, industrialists, scientists and others around the world. Increasing prosperity through institutions, policies and activities that at least maintain, and preferably enhance, the ecological

capital base on which all economic development depends, is a challenge they can understand and address.

A transition to sustainable development will require significant—and politically difficult—changes in many current policies—economic, trade, energy, agricultural, industry and other policies. Many of these policies actively—even if unintentionally—encourage forms of development that systematically degrade and deplete our basic ecological capital. They are not sustainable.

"Our Common Future" is full of examples of how many unsustainable policies can be turned around in ways that would enhance not only our base of ecological capital, but also our economic prospects nationally and internationally. Let us take a few examples from the chapters on energy, agriculture and international economic relations.

Meeting Energy Needs

In discussing a transition to sustainable development, the importance of the world's energy path is primordial. It is central to many of our most critical global problems. Our economies are powered by fuels that are non-renewable and that cause a steady drawdown of the planet's basic environmental resource capital—forests, waters, soils. Fossil fuels are also the main factor behind the rapid warming of the earth that, recent evidence suggests, has already commenced.[2]

Acidification of the Environment

In Europe and North America, prolonged acidification of the environment has raised the threat of widespread deforestation leading to massive soil erosion, siltation of rivers and flooding of valley farmlands and towns. Over 20 percent of all European forestland is now affected by dieback and the figures are mounting at an alarming rate. In the Federal Republic of Germany, for example, the figures rose from 35 percent in 1983 to over 50 percent in 1985.

Some scientists believe that decades of accumulation in the soils of Europe and North America is resulting in irreversible acidification, the remedial costs of which are beyond reach. The overall impact of this on our ability to sustain higher levels of food production has not been assessed, but laboratory experiments in Japan suggest that even much lower levels of acidification can reduce rice and wheat yields in some soils by 30 percent.

Evidence of acidification is now beginning to emerge in the newly industrializing countries of Asia, Africa and Latin America. Parts of China, Korea, Brazil, Columbia and Ecuador seem particularly vulnerable. China has committed itself to reach western

levels of energy production, based on its large reserves of coal. Japan, situated downwind from China, is clearly under threat from these potential emissions.

Global Warming

During the General Assembly's debate on the Commission's report, the President of the Maldives galvanized the Assembly with a plea for action to prevent the physical disappearance of his nation. The highest point in the Maldives is less than two meters above sea level. Most of that nation of 1,190 islands is below one metre. A temperature increase of 1 to 4.5 degrees centigrade at the equator and a sea level rise of up to one and one-half meters is highly probable within the next 40 to 60 years, according to the scientists closest to the issue. Significantly greater temperature increases can be anticipated at higher latitudes.

The prospects of major shifts in precipitation patterns and other consequences of global warming carry enormous implications for agriculture, food security, the provision of energy and other matters basic to the security and well-being of people, communities and nations. The most densely populated and economically productive coastal areas of many nations are threatened with a man-induced invasion of water that could not only wipe them out, but also force mass evacuations of peoples and communities, change national boundaries and greatly increase social and inter-state tensions. This could happen within a shorter period of time than has elapsed since the Second World War.

Given the inertia of the physical systems involved and the time lags in the political systems, the parameters for national and regional security have already been changed. So have the parameters for decisions governing the nature and location of major investments in, for example, settlements, infrastructure, and hydro-electric dams.

Coastal regions are a case in point. More than 50 percent of the world's population, and perhaps as much of its productive capacity, are concentrated in coastal areas. These areas are under tremendous growth pressures from population, investment, pollution, flooding and upland water diversions. The consequences of sea-level rise in these areas will generally outweigh those of temperature increases. On top of inundation, high tides and storm surges will penetrate even further inland. The effects of direct consequence to food security include: impact on fisheries and aquaculture resources; erosion of coastal margins; loss of wetlands; damage to port facilities and water management systems (e.g., drainage and irrigation systems and saltwater intrusion into groundwater, rivers, bays and farmland).[3]

In "Our Common Future", the Commission discusses strategies for global warming, and other interrlated phenomena, with a focus on prevention or limitation, and adaptation. Given the time lags, however, a concerted effort on limitation before the turn of the century seems very unlikely. Considerable adaptation will therefore be necessary to respond to changes already in the system.

The Commission found that no mix of energy sources that could meet future needs in ways that are dependable, safe and environmentally sound. Each of the hard options—oil, coal and nuclear—has its problems. Fossil fuels are the main factor behind acidification and the rapid warming of the earth. We have yet to solve, at least politically, the issues of nuclear waste, safety and proliferation.

There are three paths that offer a part way out of the present dilemma: first, in the short term, greatly improved energy efficiency; second, in the medium to longer term, greater emphasis on renewable energies; and third, a massive shift in research and development to new and renewable sources.

Measures to increase energy productivity are the most important weapons that we have to combat air pollution, acidification and climate change—all at the same time. They are also the most economically attractive source of energy available to most countries today. Enormous investments in energy productivity can be justified by conventional economic criteria alone.

Energy efficiency is not a hypothetical source of new energy. During the past 15 years, the energy content of GDP in all industrial market economies fell significantly. Japan led in this. Canada followed far behind. While other nations exposed their industries to market forces that forced them to shift to energy efficient plant and processes, Canadian industry was sheltered behind a subsidy wall that encouraged it to do the opposite. According to the IEA, energy efficiency in Canada improved by 6 percent, between 1973 and 1985, about the same as Australia. West Germany's improved by 23 percent. Japan, however, secured an improvement of 31 percent.

The non-market economies of Eastern Europe did not share in this efficiency revolution. Evidence is hard to obtain, but most of it suggests that, without the pressure of market prices, East European countries made no gains and continue to fall behind. The same is true of many developing countries, including most of the OPEC nations.

Since 1973, industry has led the way to improved energy efficiency in OECD countries, with a fall of 30 percent in the energy content of industrial production. But we have just begun to scratch the potential for energy and resource efficiency. If that were not true, the optimism underlying the Commission's report would be ill-founded indeed. A paper presented to the recent International Conference on Environment and Development in Milan states that, contrary to conventional wisdom, end-use energy efficiency in most sectors seldom exceeds 3 percent.[4]

What has been said about energy efficiency is true of most other materials and resources. OECD, and now the Commission, have both documented that those companies that are today on the leading edge of their industry, technologically and competitively, are usually the most energy and resource efficient and, hence, the most environmentally efficient. This is true in the steel industry, chemicals, food processing, pulp and paper, petroleum, distilleries and most others. The integration of environmental considerations into investment decisions in these companies has led to a steady reduction in their use of energy, water, chemicals and other resources per unit of production. The result has been

not only a reduction in pollution, but also an increase in productivity, profitability and competition.

If sustainable development is about anything, it is about macroeconomic performance. Increasing energy and resource efficiency at the level of an industrial plant or a community adds up to increasing the efficiency of the national economy. When industry, agriculture and local communities achieve higher levels of resource and environmental productivity, the national economy in which they operate becomes more competitive.

Japan is perhaps the outstanding example. In 1984, Japan used only about 60 percent as much energy and raw material for every unit of industrial production as it used ten years earlier, in 1973. Sweden, Germany and a few other countries shared in this experience.

All governments, but in particular the governments of developing countries, need urgently to give much higher priority to measures to encourage more sustainable forms of industrial development. If they don't do so, it is hard to see how they will reverse the increasing pollution and destruction of the resource base they now confront. Moreover, if they continue to attract industries that use higher levels of energy, water and other resources per unit of production—and are consequently inefficient and polluting—their future potential for development and income growth will decline, not increase, and the competitive position of their economies will worsen.

Governments could do much more to encourage industry in these directions. This would require a coherent deployment of fiscal, tax and trade measures, export credit and depreciation allowances, regional development grants, resource development leases and other policies. But it is a rare government that considers these policies as "environmental" policies. The Commission found none that has examined them from this perspective. The agencies concerned—treasury, trade, energy, agricultural and other similar ministries—are usually under no mandate or directive to do so. The Commission recommends that this change.

Sustainable Agricultural Policies

Food and agriculture provides another example of how policies that encourage a drawdown of basic resource capital could be turned around.

Virtually the entire food cycle in North America, Japan and Western Europe now attracts a wide range of production, price, storage and export subsidies. They cost western governments in excess of $150 billion a year, according to the OECD. Some estimates range as high as $300 billion. Ecologically blind and economically distorting, a lot of the problems confronting world agriculture can be traced to them.

These subsidies encourage farmers to occupy marginal lands and to clear forests and woodlands essential for soil and water conservation. They induce them to over-use

pesticides and fertilizers, to waste underground and surface waters for irrigation. They underwrite practices which accelerate erosion and other forms of permanent degradation of the soil and water base. This costs Canadian farmers alone over one billion dollars a year in lost production.[5]

These subsidies also encourage overproduction and market gluts—and they generate political pressures for still more subsidies to increase exports and to compensate farmers for the resulting fall in prices and lost income. The resulting trade wars have almost ruined the industry.

Poor Third World farmers are the hardest hit. They are unable to compete with rich country surpluses dumped at subsidized prices, and trade barriers against imported food products in which they have a clear comparative advantage. Moreover, these practices undercut the politics of reforming their own agricultural policies. As a result, large numbers of rural poor remain in marginal environments longer than they otherwise would, over-harvesting fuelwood stocks and grasslands, and stimulating the spread of deserts.

Everyone loses. Every ten seconds, the world's population grows by 25 people; every 14 seconds, the planet's stock of arable land falls by one hectare. Clearly, this process cannot continue.

Conservation programs can't begin to compete with these powerful subsidies. Farmers everywhere know how to read contradictory signals from governments. If they didn't, they wouldn't survive. When it comes to deciding whether to graze marginal lands or plant them with cash crops, the subsidies provided by agricultural ministries, backed by multi-billion dollar budgets, provide them with far more powerful signals than do small grants for soil conservation provided by environment agencies. While constituency polls usually provide sufficient justification for the former, in some countries the latter must run the gauntlet of so-called benefit-cost analysis, in spite of the fact that this method of assessment is totally inappropriate for investment leading to irreversible depletion of essential capital, such as soils.

These policies are not sustainable. If we must subsidize—and politicians are not likely to give up that proven path to power—let us learn to subsidize in ecologically sensible ways. We did in North America in the 1930s, and stopped the spreading dust bowl. "Our Common Future" indicates how agricultural and related trade and aid policies can be redesigned, and agricultural budgets, national and international, redeployed in ways that not only maintain farm income—which is vital for sustainable agriculture—but also encourage farmers to adopt practices that enhance their essential soil and water base rather than deplete it. At the same time, overall burdens on public budgets can be greatly reduced. Assistance to developing countries can also be provided in ways that support essential domestic reforms to increase production and to reverse accelerating degradation of their resource base.

International Economic Relations

Within the context of international economic relations, we took a careful look at relations between the developing and industrialized countries. The resource-based economies of the Third World are caught in a multiple bind. They have to build their own settlements, industries, roads, transport and so on, at a pace that the developed world never had to contemplate. They have to export more and more of their resources to earn the external capital for this. But with present monetary and fiscal relationships, and with certain forms of trade—in tropical forests, for example, and in some agricultural products and minerals—this development often reduces rather than increases their future potential for development.

The enormous external debt of many developing countries, especially in Africa and Latin America—roughly $1 trillion and gaining at some $60 billion a year—represents one of the greatest threats to sustainable development globally. Debtor nations with resource-based economies must further increase the export of their resources to earn the external capital needed for payments, but they can't catch up. With interest payments of over $80 billion a year, the traditional net flow of capital from the industrial to developing countries has been reversed. Today, nearly $30 billion annually is transferred from the developing to the industrialized countries.

And that's only what's visible; what the accountants can estimate. In addition, the Commission found that today's trading patterns contain a massive transfer of the environmental damage costs of global GNP from the industrial OECD countries to the poorer resource-based economies. We estimated that about $14 billion a year is transferred from the South to the North as a hidden environmental subsidy. This amount is close to one-third of the total amount of development assistance flowing annually in the other direction. Moreover, $14 billion seriously underestimates the real costs of environmental and resource damage in developing countries embodied in their trade with OECD countries. It relates only to environmental pollution. It does not include anything for the economic damage costs associated with resource depletion.

The trade, aid and private investment policies of a number of countries actively promote development that is unsustainable. In the case of tropical forests, commercial logging is responsible for the loss of 12.5 million hectares every year. The international trade in tropical timber is worth about $8 billion annually, of which over two billion is accounted for by the EEC, and the rest largely by Japan and the USA. If a value were placed on the loss of associated species, increased flooding, erosion, soil loss and other damage, some doubt that the activity would show a net return to the export economies concerned. The value of this trade is projected to fall to $2 billion by the year 2000. Bad ecology makes for bad economics. The Commission has put forward a number of recommendations concerning these policies. The recent International Tropical Timber Agreement, located in Japan, offers one modest means of remedy, but it is much too early to say whether it will be effective.

Domestic policies also reinforce the over-exploitation of the rain forests. In parts of Brazil, Colombia, Peru and Ecuador, for example, cattle ranchers, small-scale farmers

and poor settlers are actively encouraged, largely through fiscal and tax incentives, to head for Amazonia and establish their enterprises at cost of the rainforest.[6]

These arrangements are not sustainable. The Commission calls for a significant improvement not only in the quantity of capital flows and, in particular, concessional flows for low-income countries, but also in their quality. New measures are needed to ensure that all projects support sustainable development, and special programs are needed to strengthen institutional capacity for sustainable development.

The World Bank Group, UNCTAD, GATT, the IMF and all the specialized agencies have a major role to play in this. They are coming to realize that too often their trade and aid policies and their loans and structural adjustment programs have ignored the environmental and resource basis of development. As a result, they have often undermined the viability of that development, impoverished large numbers of people, and reduced, not increased, the recipient communities' potential for future development. In short, they have promoted unsustainable development.

At present, these great global agencies are not in any formal way responsible or accountable for the impact of their policies and programs on the planet's resource base. Some, however, may be moving in this direction. The new President of the World Bank, for example, has committed himself to the principle of sustainable development as a cornerstone of future Bank policy.

Canada has cancelled all official debt owed to it by African countries, as have the Nordics and some other countries. Japan is reported considering a plan for debt relief, as are other countries. However laudatory these plans may be, official commentary suggests that no consideration is being given to ways in which they might be deployed to at least maintain, and preferably increase, the environmental resource capital of these countries. Why not favour and support countries that can devise credible strategies for sustainable economic development—including efforts to increase energy and resource efficiency, replant forests, protect coastal resources, habitat and species, conserve soils?

Investing in The Future

There is urgent need to increase substantially the financial resources for environmental protection and sustainable development. Central and sectoral agencies which are made directly responsible for sustainable development should gradually build into their budgets the funds needed to maintain and enhance the resource and environmental stocks they use or affect. Countries would thus avoid paying more to repair damage later.

In the meantime, nations and international organizations should spend more on undoing the damage from past, or projected, development. Developing countries, in particular, need a significant increase in financial support to implement sustainable development policies, and this will have to be channelled largely through existing institutions—bilateral and multilateral agencies, banks and specialized bodies.

There are a number of activities of the UN system that need to be financed through more dependable revenues. This has become vital in the case of programs to manage, protect and restore basic Earth resources and life-support systems, where the need for forward planning and sustained management is undermined by the uncertainties and vagaries of annual appropriations by governments. The current system guarantees ineffectiveness and inefficiency.

Several possible sources of revenue have been advanced in the past and were considered by the Commission, including levies on certain forms of international trade and on the use of the international commons. None has generated significant political support to date and the Commission recognizes that they are not likely to be seen as politically realistic in the current climate of international relations. Nonetheless, it is a direction in which we must move if we are ever to extend concepts of equity and distributive justice to a global plane and to manage effectively those Earth resources essential for sustainable development.

As a more practical step, the report urges consideration of a special international banking program linked to the World Bank to provide loans and to facilitate joint financing for the development and protection of critical habitats and ecosystems, including those of international significance. With the support of UNAP, CIDA and USAID, a feasibility study is now underway within the World Resources Institute in Washington.

Signs of Change

We released "Our Common Future" in London last April and we presented it to the United Nations in October, in a special plenary debate. It was an opportune moment. There is a growing climate for change—in the UN, for example, following a series of crises, in some East European nations which are engaged in economic and political reform, in the World Bank and certain multilateral agencies, and in North-South and East-West relations.

Prime Minister Gro Harlem Brundtland presented the Commission's recommendations. The Secretary General, Prime Ministers Ghandi, Mugabe (on behalf of the Non-Aligned Movement), and Schulter of Denmark (on behalf of European communities) and many other top political leaders spoke. Several delegations included leaders from the corporate world and from non-governmental organizations.

The resolution adopted, following the General Assembly's debate, ensured that the report was firmly entrenched on the agenda of the United Nations and its specialized agencies. It had already been taken up by several regional organizations like OECD, ASEAN and OAU, and by the World Bank and several regional banks.

These issues are a growing preoccupation of people everywhere, and governments are getting the message. In Norway, for example, the Cabinet has instructed each

ministry to review their policies against the Commission's recommendations and report back with proposals. The UK government is undertaking a systematic assessment of our recommendations. Indonesia has decided to reflect them in its new national development plan.

In Canada, our report has provoked a full-scale debate. Leaders of our largest industries, as well as academics and environmentalists, have worked with government ministers on a special Task Force to develop consensus recommendations for action in response to our report.[7] Their key recommendation, signed by the Chief Executive Officers of seven of our largest MNCs, was that responsibilities for managing the economy must be married with those for managing the environment. They proposed that central economic ministers, along with energy, agricultural and other key sectoral ministers, should be made responsible and held accountable for ensuring that their policies and budgets support development that is sustainable, both economically and environmentally.

What a change that would be! But it makes sense. After all, the most important statement of environmental policy that any government makes in any year is not to be found in the annual report of the Minister of the Environment. It is to be found in the budget of the Minister of Finance—and what it says about sales taxes, farm subsidies, industrial grants, trade concessions and all other incentives and disincentives employed by modern governments to manipulate the market. We just don't think of it that way.

Several major corporations and industrial associations have also begun to examine the concept of sustainable development and how it could apply in different sectors. A number of international and national policy institutes, including the IRPP, are launching major programs on sustainable development. So are a number of non-governmental organizations. Universities are framing graduate courses around it. Schools are trying to find ways to build it into their curricula.

International conferences are being organized or planned to advance the recommendations in several areas. The Government of Canada, for example, will host a World Conference on "The Changing Atmosphere" and its "Implications for Global Security" in Toronto next June. It is designed to achieve broad political support and momentum for a global agenda of policy action on atmospheric change.

ICSU, the International Council of Scientific Unions, is developing an International Geosphere Biosphere Program to monitor and assess Earth change. IAASA, the International Association for Advanced Systems Analysis, is launching a related program on the sustainability of the biosphere. IFIAS, the International Federation of Institutes of Advanced Studies, is launching a companion program on the Human Response to Global Change. The recent decision of CGIAR, the Coordinating Group for International Agricultural Research, to adopt "sustainability" as an objective and to reassess its priorities against sustainability criteria is further evidence of the serious response of the world's scientific community.

These issues will become the stuff of international summits. Global warming of up to 4.5 degrees centigrade, and a sea level rise of up to 1.5 metres, is only ten elections

away, at four-year intervals. That's not long. The consequences of global warming could become evident to every citizen of the world within another two elections. That alone will ensure that these issues reach and stay on summit agendas.

An international conference to review progress and establish new bench marks for sustainable development seems certain for 1992. The General Assembly has endorsed it in principle and both Canada and Sweden have offered to host it. It could and should take the form of a global summit on environment and sustainable development. Given the accelerating pace and scale of change and the collapsing time frame for effective action, nothing short of total commitment by world leaders will ensure our common future.

Notes

1. World Commission on Environment and Development, "Our Common Future," (Oxford, U.K.: Oxford University Press, 1987).

2. "A Report of the International Conference on the Assessment of the Role of Carbon Dioxide and Other Greenhouse Gases In Climate Variations and Associated Impacts," WMO No. 661, (Villach, Austria, October 9-15, 1985).

3. "Developing Policies for Responding to Climate Change," A Report of the Workshops held in Villach, Austria, September 28-October 2, 1987, and Bellagio, Italy, November 9-13, 1987. To be published.

4. R.U. Ayres, "Energy Efficiency in the US Economy: A New Case for Conservation," Presented to the International Conference on Environment and Development, Milan, Italy, March 1988. To be published.

5. A Report on Soil Erosion to the Senate of Canada, "Soil and Risk: Canada's Eroding Future," (Ottawa, 1984).

6. See, N. Myers. "Emergent Aspects of Environment: A Creative Challenge." *The Environmentalist*, Volume 7, No.3, 1987, pp. 163-174.

7. National Task Force on Environment and Economy (1987), Report of Canadian Council of Resource and Environment Ministers, Ottawa, Canada.

Comments

Toru Yano

If global environmental issues are to be studied by an international organization or institution, it raises a question of the type of mechanism that should be used. Institutions such as the United Nations are frequently perceived to have severe governability

problems. If this is the case, then to what international institutions should we go to in order to study and implement the necessary measures to redress environmental problems? Who can we entrust to deal with these issues? One obvious answer is that each concerned country should deal with them. But many Third World nations do not give much priority to environmental issues. Once again we come up against the governability dilemma in our effort to confront these global problems.

At the same time, I think that there is is a high probability that advanced nations will come to have particular environmental problems of their own. For example, in Japan we are seriously dealing with the issue of bio-technology and bio-ethics, or the question of the half-life of nuclear wastes and the disposal issue. Half-life when it comes to nuclear materials is many thousands of years and there is no assurance that humanity will even be speaking the same languages in such a distant future. The question is, how are we going to deal with such very long standing issues pertaining to the environment.

Jim MacNeill

Professor Yano's comments are very much to the point. I think that the critical issue is one of governability and governance at various levels. As he correctly points out, the United Nations is an extremely weak instrument. It may be that some of the regional organizations may have more potential. The OECD, ASEAN, SEDAC in Africa and the ANDEAN Pact may be the nucleus for stronger organizations, with autonomous secretariats, such as that of the OECD, responsible to their own governments and given responsibilities in these areas.

One of the most important tasks that Canada and Japan face as industrial advanced nations with comparatively large development assistance budgets, is to become involved in the development of institutions for more effective global governance of these issues. Since the Brundtland Commission report came out, Sweden, the Netherlands and Canada have expressed an interest in establishing new programs of institutional development.

It is true that Third World countries have not given a very high priority to environmental protection but, frankly, the model that we developed after 1972 was not very useful for them. It was an expensive add-on model that required that the damage be done first before we responded. Japan has devoted as much as 2.1 percent of GNP on environmental protection and Germany has allocated almost that. Despite this investment, the natural assets of these and other countries are declining at a rapid rate. Obviously, this is not a model that is very useful for the Third World. The Commission felt, and many representatives from the Third World were on the Commission, that environmental concerns have to be built into fiscal, trade and energy policies in order for developing countries to come to grips with these issues at a much earlier stage in the development process.

I was interested in what you said about bio-technology. The promise of genetic engineering is dazzling and if ever there is a science that has great promise for the future, bio-technology is it. On the other hand, few countries have begun to tackle the serious

moral, ethical and regulatory dilemmas that it presents. I am glad to hear that Japan is beginning to do so. To date, the only jurisdiction that has done much in this area is the state of California, where new life forms must be tested against local eco-systems. However, with modern communications and transportation systems, a new life form can be in California today and Zimbabwe tomorrow. These life forms need to be tested on a global scale.

Yutaka Kosai

I have been trained as an economist and the conventional pattern is that economists tend to be the predators of ecologists. Although this fight has been going on for a long time, I hope that ecologists will start to place more trust in market mechanisms. They can be a framework through which the necessary rectification can take place. Too great a reliance on the United Nations or other kinds of fixed international systems or institutions would tend to work in the reverse direction.

I would like to give an example to illustrate this point. Mr. MacNeill mentioned that Japan has succeeded in efficiently reducing energy consumption. But the Japanese government has made little contribution to this achievement. The simple fact is, that we couldn't afford to spend so much money on energy, so it was necessary to find ways to effect a savings. If we had had the money, Japan probably would not have taken these measures.

Junnosuke Kishida

Dr. Kosai has referred to the resource savings that can be achieved through the use of the price mechanism. If the price is high then people think about saving energy and saving other natural resources to reduce consumption. This process was successfully accomplished in the period that followed the oil crisis of 1973. However, is the price mechanism the only condition which triggers this type of effort and how can we connect environmental issues and price mechanisms? I think that a simple equation of the two, or mixing of the two factors, is not the whole answer. In order to maintain and conserve the environment, as well as fulfill the quality of life, I believe that certain institutions must be established. In the last 15 years, Japan has spent almost 20 trillion yen on environment-related activities, with particular emphasis on conservation. Japan's SO_2 emissions are down to one-fifth of the average of other industrial countries and acid rain is not as big a problem as it is in other countries, although our climatic conditions have contributed to this favourable situation. This achievement has been possible, because at an early stage Japan established institutions, or systems, which possessed compulsory powers to implement the plans we devised for environmental protection.

Thomas Shoyama

I would like to know how one factors the concept of sustainable development into economic projections. I maybe wrong, but I would be surprised if these projections take into account the strictures that are implicit, or indeed in some cases quite explicit, in the Brundtland Commission Report. I was recently at a conference workshop and we heard an exposition of the physical, political and economic setting of the world in the year 2000. There is of course, a vast gulf between each one of these settings. Some attempt is made to adjust economic projections to perceptions of how the world's political structure would evolve, but so far I have not seen any projection that says for example, that in 20 or 30 years we are going to see a rise in the ocean level of one metre. If we really believe this, we must undertake active programs to prevent, or adapt to, this type of occurrence.

Tom Wilson

I want to follow-up Professor Kosai's points about the role of price mechanisms. I think that it is useful to distinguish between certain of these problems that can be resolved through the price mechanism and those that cannot. Most economists like to emphasize the role of the prices, and it does wonders when the system of property rights is correct and when the property rights externalize all the relevant externalities. I would think that a lot of the problems related to the sheer exhaustion of some resources within a jurisdiction can be resolved by the right set of prices, the right set of development policies and so on. This is also the case with conserving energy. A lot of energy conservation is induced by rising prices.

Having said this about the price mechanism, there are very serious environmental problems where there are not any property rights. What is the price of the ozone layer in the stratosphere? Who is paying for it? Certainly nobody owns it, but in a sense we all own it and our well-being depends on it. This is an area where either we have to have an international creation or rely on regulation. In this circumstance of an extreme global public good, there is no way you can simply rely on the price mechanism. Nobody pays the price of polluting but we all suffer the costs.

Jim MacNeill

I think that the Brundtland Commission's response to the issue of the role of prices is that the market can work more effectively than it has, but at the same time it fails in respect of many issues. As we have been reminded, the market did work effectively from both an ecological and economic point of view in the area of oil prices and energy conservation. Professor Kosai was quite right in observing that the government of Japan can't take much credit for the country's exemplary achievement in energy efficiency between 1973 and 1984. If anybody should take credit for that, it should be OPEC. The fact is, that between 1973 and 1984, rising energy prices drove efficiency to the point that in 1984 OECD countries were achieving an average annual increase in energy productivity of 1 percent, and some, including Japan, were up to 2 percent. If we could maintain the

momentum of energy productivity at a rate of 1-2 percent per year, through the introduction of a system of what we call efficiency pricing or conservation pricing, we could buy 50 to 100 years on climate change. Politically this would be very difficult, as it would mean playing with the markets through federal and provincial taxes, but it is really the only way at the moment that we can reduce CO_2 emissions into the atmosphere. There is no add-on technology that we can employ. The only thing that we can do is reduce the energy content of growth.

If oil is one area where the market has worked, there are many areas where it doesn't. Trade in tropical timber is one of them. Although it is obviously not in the interests of tropical timber exporting countries to see their forests disappear, these countries face some diabolical choices. The disruption of tropical forests is driven largely by the trade in tropical timber. Most of the economies that are connected to the world trading system depend on that system to draw energy, wood, food and other materials from foreign eco-systems. We have to imagine what are known as ghost acreages. That is, the foreign eco-systems upon which our economies depend. We accept a certain responsibility to maintain our own forests and in Japan and Europe forest cover has increased since 1945. We must also begin to accept an obligation to help sustain the eco-systems upon which our trade depends. The recently negotiated international tropical timber agreement is an example of such an attempt. It is the first commodity agreement in tropical timbers that provides for the establishment of a fund, from revenues levied on the trade, to be used by the exporting countries to better manage the resource that is being traded. Although we don't know how it will work, and I am personally skeptical about its prospect for success for a number of reasons, not the least being the deep corruption that you find in the steward countries (e.g., Indonesia, Zaire, Brazil), it is nevertheless an attempt to recognize the fact that the trading system has an obligation to sustain the resources that are being traded.

Members of the Institute

Board of Directors

The Honourable Robert L. Stanfield, P.C., Q.C. (Honorary Chairman)
Ottawa

Roger Charbonneau, O.C., (Chairman)
Président, Laboratoires Anglo French, Ville de Mont Royal

Rosalie Abella
Chair, Ontario Labour Relations Board, Toronto

Robert Bandeen
Chairman and President, Cluny Corporation, Toronto

Nan-Bowles de Gaspé Beaubien
Vice-présidente du conseil d'administration, Télémédia Inc., Montréal

Larry I. Bell
Chairman and Chief Executive Officer, B.C. Hydro & Power Authority, Vancouver

Allan F. (Chip) Collins
Special Advisor, Provincial Treasurer of Alberta, Edmonton

Peter C. Dobell
Vice-President, The Institute for Research on Public Policy, Ottawa

Rod Dobell
President, The Institute for Research on Public Policy, Victoria

David Hennigar
Atlantic Regional Director, Burns Fry Limited, Halifax

Susan McCorquodale
Department of Political Science, Memorial University of Newfoundland, St. John's

Jean Monty
Executive Vice-President, Bell Canada Enterprises, Montreal

Robert Normand
Président et éditeur, *Le Soleil*, Québec
Tom Pepper
Pepper Consultants Ltd., Saskatoon
Guy Roberge, C.R.
Conseil, Clarkson, Tétrault, Ottawa
Jeff Rose
National President, Canadian Union of Public Employees, Ottawa
Robert K. Siddall
Senior Vice-President & Secretary, The Great-West Life Assurance Co., Winnipeg
Marc-Adélard Tremblay, O.C.
Département d'anthropologie, Université Laval, Sainte-Foy

President
Rod Dobell

Vice-President and Secretary-Treasurer
Peter C. Dobell

Investment Committee
Peter C. Godsoe, Chairman
Robert Bandeen
Peter C. Dobell
Michael Koerner
Alfred Wirth

Executive Committee
Roger Charbonneau, O.C., (Chairman)
Rosalie Abella
Robert Bandeen
Rod Dobell
Robert K. Siddall
Marc-Adélard Trembley

Council of Trustees

Members at Large

Ronald L. Watts, O.C. (Chairman)
Department of Political Studies, Queen's University, Kingston

Doris H. Anderson, O.C.
Toronto

Lise Bissonnette
Montreal

Roger A. Blais, O.C.
Directeur, R-D coopératifs, École Polytechnique de Montréal

Jill Bodkin
Director of Financial Services, Clarkson Gordon, Vancouver

George Cooper, Q.C.
McInnes, Cooper and Robertson, Halifax

James S. Cowan, Q.C.
Partner, Stewart, MacKeen & Covert, Halifax

V. Edward Daughney
Rosegreen Investments Ltd., Vancouver

H.E. Duckworth, O.C.
Winnipeg

Marc Eliesen
National Director of Government Affairs, Stevenson Kellogg Ernst & Whinney, Ottawa

Emery Fanjoy
Secretary, Council of Maritime Premiers, Halifax

Maureen Farrow
President, C.D. Howe Institute, Toronto

James D. Fleck
Chairman and Chief Executive Officer, Fleck Manufacturing Inc., Don Mills

Francine Harel Giasson
Directrice des programmes et professeure agrégée, L'École des Hautes Études Commerciales de Montréal

Margaret C. Harris
Past President, The National Council of Women of Canada, Saskatoon

Michael Hicks
Centre for Executive Development, Ottawa

David Hopper
Washington, D.C.

Richard W. Johnston
President, Spencer Stuart & Associates, Toronto

Leon Katz, O.C.
Saskatoon

Geraldine Kenney-Wallace
Chairman, Science Council of Canada, Ottawa

Verna Kirkness
Director, First Nations House of Learning, University of British Columbia, Vancouver

Claude Lafrance
Directeur, Centre de Recherche Industrielle de Québec, St-Foy

David Leighton
Director, National Centre for Management Research and Development
University of Western Ontario, London

Terrence Mactaggart
Mississauga
Judith Maxwell
Chairman, Economic Council of Canada, Ottawa
Milan Nastich
Canadian General Investments Ltd., Toronto
Roderick C. Nolan, P.Eng.
President, Neill & Gunter Limited, Fredericton
Robert J. Olivero
United Nations Secretariat, New York
Gordon F. Osbaldeston, O.C.
Senior Fellow, School of Business Administration, University of Western Ontario, London
Garnet T. Page, O.C.
Calgary
Jean-Guy Paquet
President and Chief Operating Officer, La Laurentienne, Quebec
Leonard Russell
Superintendent of Education, Summerside
Eldon D. Thompson
President and Chief Executive Officer, Telesat, Gloucester
Israel Unger
Dean of Science, University of New Brunswick, Fredericton
Louise B. Vaillancourt
Outremont
Ida Wasacase, C.M.
Whitewood, Saskatchewan
R. Sherman Weaver
Director, Alberta Environmental Centre, Vegreville
Blossom Wigdor
Director, Program in Gerontology, University of Toronto

Government Representatives
Roger Burke, Prince Edward Island
David R. Cameron, Ontario
Joseph H. Clarke, Nova Scotia
Ron Hewitt, Saskatchewan
Lynn Langford, British Columbia
Donald Leitch, Manitoba
Francis McGuire, New Brunswick
Barry Mellon, Alberta
Norman Riddell, Quebec
H.H. Stanley, Newfoundland
Gérard Veilleux, Canada
Louise Vertes, Northwest Territories

Institute Management

Rod Dobell	President
Peter Dobell	Vice-President and Secretary-Treasurer
Yvon Gasse	Director, Small & Medium-Sized Business Program
Jim MacNeill	Director, Environment & Sustainable Development Program
Steven Rosell	Director, Governability Research Program
Shirley Seward	Director, Studies in Social Policy
Murray Smith	Director, International Economics Program
Jeffrey Holmes	Director, Communications
Parker Staples	Director, Financial Services
Walter Stewart	Editor, *Policy Options Politiques*

Fellows- and Scholars-in-Residence:

Tom Kent	Fellow-in-Residence
Eric Kierans	Fellow-in-Residence
Jean-Luc Pepin	Fellow-in-Residence
Gordon Robertson	Fellow-in-Residence
David Cameron	Scholar-in-Residence
Gilles Paquet	Scholar-in-Residence
Klaus Stegeman	Scholar-in-Residence
Eugene M. Nesmith	Executive-in-Residence

Related Publications

Order Address

The Institute for Research on Public Policy
P.O. Box 3670 South
Halifax, Nova Scotia
B3J 3K6

1-800-565-0659 (toll free)

Keith A.J. Hay (ed.)	*Canadian Perspectives on Economic Relations With Japan.* 1980 $18.95
Roy A. Matthews	*Canada and the "Little Dragons": An Analysis of Economic Developments in Hong Kong, Taiwan, and South Korea and the Challenge/ Opportunity They Present for Canadian Interests in the 1980s.* 1983 $11.95
Yoshi Tsurumi with Rebecca R. Tsurumi	*Sogoshosha: Engines of Export-Based Growth.* (Revised Edition). 1984 $10.95
Richard W. Wright	*Japanese Business in Canada: The Elusive Alliance.* 1984 $12.00

Conference Papers	*Canada and International Trade. Volume One: Major Issues of Canadian Trade Policy. Volume Two: Canada and the Pacific Rim.* 1985 $25.00 (set)
Richard W. Wright with Susan Huggett	*A Yen for Profit: Canadian Financial Institutions in Japan.* 1987 $15.00
John W. Langford & K. Lorne Brownsey (eds.)	*The Changing Shape of Government in the Asia-Pacific Region.* 1988. $22.00
Zhang Peiji & Ralph W. Huenemann (eds.)	*China's Foreign Trade.* 1988 $12.95

The Institute for Research on Public Policy
L'Institut de recherches politiques

A national, independent, research organization
Un organisme de recherche national et indépendant

Créé en 1972, l'Institut de recherches politiques est un organisme national dont l'indépendance et l'autonomie sont assurées grâce aux revenus provenant d'un fonds de dotation auquel souscrivent les gouvernements fédéral et provinciaux ainsi que le secteur privé. L'Institut obtient en outre des subventions et des contrats des gouvernements, des compagnies et des fondations afin de réaliser certains projets de recherche.

La raison d'être de l'Institut est triple :

- Servir de catalyseur au sein de la collectivité nationale en favorisant un débat public éclairé sur les principales questions d'intérêt général.
- Stimuler la participation de tous les éléments de la collectivité nationale à l'élaboration de la politique d'État.
- Trouver des solutions réalisables aux importants problèmes d'ordre politique afin de contribuer à l'élaboration d'une saine politique d'État.

Un Conseil d'administration, chargé de la décision, et une Commission de direction, responsable d'éclairer le Conseil sur l'orientation de la recherche, assurent la direction de l'Institut. L'administration courante des politiques, des programmes et du personnel relève du président.

L'Institut fonctionne de manière décentralisée et retient les services de chercheurs en divers points du Canada, s'assurant ainsi que toutes les régions contribuent aux recherches.

L'Institut cherche à favoriser, dans la mesure du possible, la compréhension et la discussion publiques des questions d'envergure nationale, controversées ou non. Il publie les conclusions de ses recherches avec clarté et impartialité. Les recommandations ou les conclusions énoncées dans les publications de l'Institut sont strictement celles de l'auteur et n'engagent aucunement le Conseil d'administration, la Commission de direction ou les bailleurs de fonds.

Le président assume la responsabilité ultime de publier un manuscrit au nom de l'Institut. Il jouit à cette fin des conseils du personnel de l'Institut et de critiques de l'extérieur quant à l'exactitude et à l'objectivité du texte. Ne sont publiés que les textes qui traitent de façon compétente d'un sujet digne de la réflexion du public.

Canada—Japan:
Policy Issues for the Future

Edited by K. Lorne Brownsey

The papers in this volume were presented at a symposium held in Vancouver in April 1988, co-sponsored by the Institute for Research on Public Policy (IRPP) and Japan's National Institute for Research Advancement (NIRA). They provide an overview of some of the key policy issues that both countries are facing as they prepare to enter the 1990s. Their scope is wide and at times quite speculative: ranging from descriptions of possible realigned world political orders to questions of international trade and domestic political priorities; from the "greying" of the populations of the industrial world to the imperative of implementing sustainable economic development worldwide; and they centre on the many vexing challenges of governability that all nation states are now confronting.

ISBN 0-88645-086-1

The Institute for Research on Public Policy
L'Institut de recherches politiques
A national, independent, research organization
Un organisme de recherche national et indépendant